RIGHTS IN OVERDUE PAPER

[*Dedicated to* Ezra Ripley Thayer]

ONE reason for the slow progress of law as compared with medicine or the natural sciences is the impossibility of experimentation. A law professor cannot try out his new descent and distribution statute on the community to see how it works, as a research doctor tries out antitoxins on a guinea pig. The lawyer cannot deliberately isolate legal transactions for investigation, but must take the tangled facts as he finds them. Another scientific method is, however, open to us. Although we cannot artificially produce simplification, we can search for it. After all, law only faces the same difficulties as the other social sciences and even psychology. Like them it can sometimes understand a complex group of factors which constitute a normal situation by finding and observing an abnormal situation from which some of these factors are absent. Mme. Montessori has worked out new theories for the training of a child of average intelligence after studying the slower development of the feeble-minded. Drunkenness removes the inhibitions and preoccupations of daily life, revealing a few primitive emotions in a magnified form. In like manner, the true nature of a legal ight becomes more apparent if we can find it transported to foreign soil in a conflict-of-laws case,[1] and such an everyday phenomenon as the interest of a beneficiary under a trust was thrown into a glaring high light by the peculiar facts of *In re Nisbet and Potts' Contract*,[2] after prolonged examination of the normal situation had not revealed the correct theory of the nature of the interest to so able a thinker as Maitland.

This article is an endeavor to test a theory of negotiable instruments by its application to the abnormal conditions of overdue paper. The investigation will be directed toward one problem, the position of a *bonâ fide* purchaser for value after maturity from a

[1] See for instance the recent cases on the extraterritorial operation of Workmen's Compensation acts; and Alcock *v.* Smith, L. R. (1892) 1 Ch. 238 (C. A.), discussed *infra*, page 1143.

[2] L. R. (1905) 1 Ch. 391; L. R. (1906) 1 Ch. 386 (C. A.), showing that a *cestui que trust* has an equitable right *in rem* against the land and not merely a right *in personam* against the holder of the legal title.

wrongdoer, of an instrument which is payable to bearer or properly indorsed to the purchaser, and free from defenses as regards the original obligor, but subject to claims of ownership of which the purchaser has no notice. In other words, the person from whom he buys has no right to sell and is wrongfully seeking to deprive some one else of the paper or its proceeds when collected. Can the *bonâ fide* purchaser keep and enforce the instrument, or must he surrender it to the victim of the wrong?

I. Theories of Negotiability

Examination of the decisions and text-writers [3] shows not only a wide difference of opinion as to which of these two innocent persons should prevail, but also great uncertainty as to the theoretical nature of an overdue negotiable instrument. Indeed, it is sometimes said not to be a negotiable instrument at all. Thus Langdell, Ames, and some judges have called it an ordinary chose in action,[4] which must mean a non-negotiable chose in action. If this were literally true, consideration would not be presumed and the holder could not sue in his own name. Of course no one supports such a conclusion, and Ames is careful to state that the instruments are still "by an anomaly, assignable." A radically different view is taken by Lord Campbell and Justice Erle in the first English case to consider our problem carefully,[5] and by some American

[3] *References to discussions in textbooks, articles, etc., as to equities of former holders and outsiders in overdue paper:* "Some Problems in Overdue Paper," Francis R. Jones, 11 Harv. L. Rev. 40; Ames, Cases on Bills and Notes, I, 747, 894, notes; II, 853; (but these passages were written about 1881 and do not altogether represent Mr. Ames' later views); Norton on Bills and Notes (4 ed), 271; 1 Daniel on Negotiable Instruments (6 ed.) §§ 724 *ff*, 782; Story on Promissory Notes (6 ed.), §§ 178, 179; Chalmers' Bills of Exchange (7 ed.), 128; Ewart on Estoppel, 423; 46 L. R. A. 753, note; 2 L. R. A. (n. s.) 767, note; 5 A. & E. Ann. Cas. 581, note.

[4] Ames, Cases on Bills and Notes, II, 853. "The career of a bill properly ends with its payment, or dishonor at maturity. If paid, it is *functus officio;* if dishonored, it can no longer adequately perform its function as a representation of money, but is transferred into an ordinary chose in action. But by an anomaly, bills and notes, though overdue, are assignable."

Hinckley *v.* Union Pacific, 129 Mass. 52, 61 (1880), per Lord, J.: "After maturity, a coupon, like any other negotiable security, loses the protection of the law merchant, and becomes a mere chose in action." (This passage embodies Langdell's views. Ames, Lectures on Legal History, 481.) Hinckley *v.* National Bank, 131 Mass. 147 (1881); Henderson *v.* Case, 31 La. Ann. 215, 216 (1879).

[5] Ashurst *v.* Bank, 27 L. T. 168 (1856). Lord Campbell, C. J.: "Though called a negotiable instrument it was in truth a chattel, and only transferable like any other

courts,[6] that an overdue instrument ceases to be negotiable and becomes a chattel, ordinary personal property like a horse. A chattel which gives rise to an action of assumpsit is well worth investigation.

On the other hand, it is repeatedly stated on the highest authority that an overdue instrument is negotiable.[7]

The clash of opinion on this point of negotiability is, however, more apparent than real, and is caused either by the use of analogous instances as if they were identical instances, or else by the employment of the word "negotiable" in two very different senses. Crompton, J., in the early English case just mentioned, points out the need of care in the use of this term.[8] In what sense is an overdue instrument negotiable, and in what sense not? A negotiable instrument not yet due differs from a mere chose in action in several ways, two of which are often called "negotiability." *First*, the transferee is not forced to sue in the name of the original obligee, but sues in his own name. *Secondly*, equities are cut off. (A further distinction, that consideration is presumed, the instrument itself giving a right of action, is also possessed by non-negotiable bills and notes and hence is never a source of confusion like the two other characteristics of negotiable instruments.)

Now if by "negotiable" we mean transferable, then it is clear that an overdue instrument is just as negotiable as it ever was. Aside from questions of the effect of wrongdoing, it is treated

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chattel." Erle, J.: "It seems to me extremely important to draw the line clearly between negotiable instruments, properly so called, and ordinary chattels, which are transferable by delivery, though the transferor can only pass such title as he himself had." But see the view of Crompton, J., in note 8.

[6] Wylie *v.* Speyer, 62 How. Pr. (N. Y.) 107, 110 (1881). Van Vorst, J.: "After their maturity, the coupons lost the attribute of negotiability, and they dropped into the category of ordinary property, to which title does not pass by delivery."

Wood *v.* McKean, 64 Iowa, 16 (1884).

[7] Crossley *v.* Ham, 13 East, 498 (1811), Bayley, J., and Ellenborough, C. J.; Graves *v.* Key, 3 B. & Ad. 313, 317 (1832), Tenterden, C. J.; Baxter *v.* Little, 6 Met. (Mass.) 7, 10 (1843), Shaw, C. J.; Fisher *v.* Leland, 4 Cush. (Mass.) 456, 459 (1849), Shaw, C. J. See also the early caution of Buller, J., in Brown *v.* Davies, 3 T. R. 80 (1789).

[8] Crompton, J., in Ashurst *v.* Bank, 27 L. T. 168 (1856): "I do not think it correct to say that after maturity it becomes like a mere chattel, for the negotiability continues in all its strictness. In these cases, two things are to be considered. Generally, a chose in action is not assignable; but, with regard to negotiable instruments, as bills and promissory notes, a different rule obtains, and they are negotiable by delivery. But the question of negotiability is different from the question of title."

exactly the same as before maturity.[9] It is transferred in the same way, by delivery or by indorsement, and by the same form of indorsement, the word "order" not being a necessary part thereof.[10] An indorser after maturity promises to pay on demand, but his liability otherwise is identical. Demand and notice are necessary to charge him.[11] The holder sues in his own name upon the instrument, as was settled by Lord Holt and the merchants at conference on a summer's day of 1699,[12] and the holder can do this even if suit had been started by his predecessor in title.[13] An overdue note is consequently negotiable within the terms of a statute exempting debts secured by "negotiable promissory notes" from garnishment.[14] In short, after maturity as much as before, the paper is intended to circulate and the transferee is himself the promisee of the contract. The promise is not limited to the payee or first holder alone or even to holders before maturity, but runs as a direct promise to every "bearer" of the instrument or to every person duly constituted the "order" of the payee. This direct promise continues up to the very moment that the instrument is discharged.

Therefore, those authorities which declare that overdue paper is not "negotiable" refer only to the second meaning of the word, the complete cutting off of equities by transfer. It is the presence

[9] Capwell *v.* Machon, 21 R. I. 520, 522, 45 Atl. 259 (1900). Stiness, J.: "The fact that a negotiable note is transferred after maturity is not important, except as to equities between prior parties."

[10] Leavitt *v.* Putnam, 3 Comst. (N. Y.) 494 (1850). Hurlbut, J.: "A bill or note does not lose its negotiable character by being dishonored. If originally negotiable, it may still pass from hand to hand *ad infinitum* until paid. . . . Thus, the paper preserves its mercantile existence, and retains the main attributes of a proper bill or note, and circulates as such in the commercial community. . . . Both the note and its indorsement, by a long course of decisions, have been treated as within the law merchant in respect to their main attributes."

[11] Colt *v.* Barnard, 18 Pick. (Mass.) 260 (1836).

[12] Mutford *v.* Walcot, 1 Ld. Raym. 574, 575 (1701): "And Holt, chief justice, said that he remembered a case where an action was brought upon a bill of exchange and the plaintiff declared upon the bill, where it was negotiated after the day of payment; and a question was made, whether the plaintiff could declare upon the bill, or whether he ought to bring *indebitatus assumpsit*. And he said, that he had all the eminent merchants in *London* with him at his chambers at *Sergeants-Inn* in the long vacation about two years ago, and they all held it to be very common, and usual, and a very good practice."

[13] Deuters *v.* Townsend, 5 B. & S. 613 (1864).

[14] Oakdale Mfg. Co. *v.* Clarke, 29 R. I. 192, 69 Atl. 681 (1908). The historical discussion in this case is wrong in saying that equities were not cut off before 1745. See Holdsworth in 31 L. Quart. Rev. 173, 184; 32 L. Quart. Rev. 20, 26–27.

of this quality which constitutes the difference between current and overdue paper, aside from the necessary postponement of payment because of the dishonor at maturity. So far there is no disagreement.

And now we arrive at our main problem. When we ask, "Is this quality of cutting off equities wholly absent from overdue paper so that all equities run after maturity, or are some equities cut off and not others?" war unceasing rages. Here lies the special task of this article. If overdue paper is wholly non-negotiable in this second sense, then the *bonâ fide* purchaser from a wrongdoer after maturity will never be protected. If, on the other hand, equities are cut off under some circumstances and not under others, it is highly important for business men as well as lawyers to know with accuracy what those circumstances are. And if this accuracy be unattainable in the welter of decisions, at least we can endeavor to learn what the rules as to the position of the *bonâ fide* purchaser ought to be, and to secure those rules by legislation in all the States.

The solution of this problem which is supported by this article as most in accord with the true principles of bills and notes is: *Bonâ fide purchase for value after maturity gives legal title and cuts off equities of ownership but not equities of defense.* In other words, the *bonâ fide* purchaser for value without notice of an overdue instrument payable to bearer, indorsed in blank, or specially indorsed to him, has legal title to the instrument and can keep it, regardless of any wrongs committed upon prior owners or other persons, and can recover upon it against any prior party who has not an equitable defense of his own, but cannot recover against any party who has such a defense.[15]

The theory of negotiable instruments on which this solution rests involves two propositions which it is necessary to discuss at some length. The first relates to the division just mentioned between equities of ownership and equities of defense, the second

[15] This solution is by no means original with the writer. It was reached by Mr. Ames subsequently to the publication of his "Cases on Bills and Notes," which of course present a different view, and it has been accepted by other teachers of law. Ewart takes the same position in his ESTOPPEL, pages 423–24. The best judicial expression is in the recent case of Wolf *v.* American, 214 Fed. 761 (C. C. A. 7th 1914). A slightly different view is presented by Francis R. Jones, "Some Problems in Overdue Paper," 11 HARV. L. REV. 40.

to the passage of legal title to a possessor within the description of the instrument whether overdue or not.

1. *There are two distinct classes of equities affecting a negotiable instrument, equitable claims to ownership and equitable defenses to liability on the contracts*

The second kind of "negotiability," the cutting off of equities, is such a common phenomenon and we are so used to seeing the holder in due course start with a clean slate, that we frequently fail to observe that two entirely different sorts of equities existed before the transfer. Both white and red chalk marks have been sponged from the slate. This distinction between "equities" as to liability and "equities" as to ownership is fundamental, and is one more instance of the dangers lurking in that ambiguous word.

These two kinds of equities correspond to the duplex nature of the negotiable instrument itself. We have seen how some persons call an overdue instrument a chose in action and others call it a chattel. In truth, a bill or note, whether overdue or not, is both a chattel and a chose in action — or more frequently several choses in action. It is a chattel, a tangible scrap of paper, sometimes valuable for its own sake if sufficiently ancient or bearing the autograph of some historic debtor like Dick Steele or William Pitt or Daniel Webster, always available for framing or even papering the wall, for which purpose unlucky investors have used their coupon bonds. As a chattel, it is the subject of conversion which gives rise to trover, has been held to be covered by the designation "goods and chattels" in the Statute of Frauds, and is taxable where situated, though the owner and the obligor reside elsewhere.[16]

Secondly, a bill or note is a bundle of contracts. Its ownership involves not only the right to possess a thing but the right to sue several persons — maker, drawer and acceptor, indorsers. The promises and the chattel are inseparable. The right to hold the paper and the right to enforce the obligation are in the same person.[17] If an illustration from ichthyology be permissible, the duplex

[16] AMES, CASES ON BILLS AND NOTES, II, 799, 800; Wheeler *v.* New York, 233 U. S. 434 (1914).

[17] Perreira *v.* Jopp, cited in 10 B. & C. 452 (1830) note; II AMES, CASES ON BILLS AND NOTES, II, 51 note. Lord Kenyon reports an amusing colloquy between Lord Mansfield and counsel as to the supposititious case of a promissory note engraved on a diamond ring, which would test Mansfield's statement, "he could never bring himself

nature of a negotiable instrument, this piece of property from which depend numerous obligations running in different directions, always reminds me of a jelly-fish with its streamers.

Now, equities must be classified accordingly as they relate to the ownership of the chattel or to liability on some obligation. If the bearer of a note payable to bearer is induced by fraud to deliver it, he has an equitable right to restitution of his property. He is in no danger of liability upon the instrument, but he wants it back so that he may collect it at maturity. He asserts his equitable claim to ownership in an action of trover [18] just like a person from whom a horse has been bought by fraud.[19] The legal proceeding is only a substitute for a bill in equity for restitution,[20] such as the Duke of Somerset brought for "the old altar-piece made of silver, remarkable for a Greek inscription and dedication to Hercules." [21] A person who never had title to a bill or became a party to it may have an equitable claim to its ownership because it is held in trust for him [22] or because it was wrongfully bought with his money [23] or because his debtor made a conveyance of the instrument in fraud of creditors.[24] The equity in these cases has nothing to do with liability, for there is no liability. The remedy is affirmative and not defensive.

Equities as to liability are entirely different in their nature. If the maker of a note is induced to sign it by fraud, he has an equitable defense at law when he is sued on the contract. In this case the parallel in chancery for his relief is a permanent injunction against the action at law on the obligation.[25] If this were a specialty

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to think for a moment that a man who had no title to the value of a bill or note, could recover in an action of trover for the paper merely, which was of no value whatever."

[18] Ames, Cases on Bills and Notes, II, 693. The measure of damages is the amount recoverable, *prima facie* the face value.

[19] Williston on Sales, § 567.

[20] "Purchase for Value without Notice," J. B. Ames, 1 Harv. L. Rev. 1, 4, note. (Lectures on Legal History, 256, note): "In truth the fraudulent vendee who gets the title is a constructive trustee, and the action of trover against him presents the anomaly of a bill in equity in a court of common law."

[21] Duke of Somerset *v.* Cookson, 3 P. Wms. 389 (1735).

[22] Turner *v.* Hoyle, 95 Mo. 337, 8 S. W. 157 (1888).

[23] *In re* European Bank, L. R. 5 Ch. App. 358 (1870).

[24] Sanderson *v.* Crane, 2 Green (14 N. J. L.) 506 (1834).

[25] Mines Royal Societies *v.* Magnay, 10 Exch. 489, 493 (1854); Steele *v.* Haddock, 10 Exch. 643 (1855); Wood *v.* Copper Miners, 17 C. B. 561, 591 (1856). Mass. Stat. 1883, c. 223, § 14, permits a defendant to allege, as a defense in an action at law, "any

instead of a negotiable instrument, the defrauded obligor would before modern statutes have had to go into chancery to maintain his defense,[26] and the equitable defense on a negotiable instrument is precisely the same kind of relief in a law court, which in effect enjoins suit on the instrument. Instead of waiting until he is sued on the bill or note and setting up his equitable defense at law, the obligor may use it as the basis of a bill in equity to enjoin negotiation and have the paper surrendered for cancellation, so that it may not get into the hands of a holder in due course and the defense be lost. Such a proceeding, though affirmative in form, is defensive in substance and wholly unlike the proceeding in chancery for restitution on the basis of an equitable claim to ownership. The maker of a note asserts an equitable defense, not an equity of ownership. He has no right to get the note back and sue on it. The holder may be forced to surrender the note but it does not go back to the maker. It is canceled and kept by the clerk of the court. A bill for cancellation is so completely unlike a bill for restitution that it does not even necessitate a technical right to the paper upon which the instrument is written. Cancellation will be given even though the obligor's signature was fraudulently obtained upon paper belonging to the obligee, or was forged, so that the obligor never had anything to do with the paper at all.[27]

In short, the two classes of equities are entirely distinct. The equities as to ownership are property rights in a chattel with its dependent obligations, on which the claimant wants to sue as plaintiff. The equities as to liability are at the opposite end of those obligations. Instead of being property rights (the basis of *vindicationes* in Roman law), they are set up by a defendant as defenses (*exceptiones*) to litigation on a contract. Equitable claims to ownership are no more like equitable defenses than a declaration in trover is like a plea of payment. They have been confused because they have both been called "equities" and because the

facts that would entitle him in equity to be absolutely and unconditionally relieved against the plaintiff's claim or cause of action."

[26] "Specialty Contracts and Equitable Defenses," J. B. Ames, 9 HARV. L. REV. 49; AMES, LECTURES ON LEGAL HISTORY, 104.

[27] Davis *v.* Manson, 102 Atl. (R. I.) 714 (1918). Cases in which the cancellation of overdue paper is ordered clearly proceed on defensive grounds. Fuller *v.* Percival, 126 Mass. 381 (1879); Atlantic *v.* Tredick, 5 R. I. 171 (1858).

same person is frequently entitled to set up both an equitable claim to the restitution of the instrument and an equitable defense if he is sued upon it. In the illustrations just given only one kind of equity was present, but take the case of an indorser who transfers a note without consideration to an attorney for purposes of collection and the attorney keeps the note and sues the indorser on his indorsement. The indorser will have an equitable defense of lack of value, and also an equitable claim to get the note back. Another reason for the failure to separate the two classes of equities is that there is no practical need to do so in the ordinary case of current paper, since transfer of the legal title before maturity to a *bonâ fide* purchaser for value without notice cuts off both equities of ownership and equitable defenses without distinction.

This brings us to our second proposition. How does the legal title get into a *bonâ fide* purchaser?

2. *The legal title to a negotiable instrument throughout its existence belongs to the person to whom the promises run by the terms of the instrument if he has possession, no matter how that possession came to him.*

This proposition is extremely important for our problem because if it be sound, the fact that a *bonâ fide* purchaser after maturity takes from a wrongdoer, even a defrauder or a thief, will be immaterial to deprive him of protection. He has legal title, and where equities are equal the legal title prevails. On the other hand, if possession by one within the description of the instrument does not always involve legal title, it will be necessary to determine the conditions under which possession does or does not confer legal title upon the *bonâ fide* purchaser after maturity.

The validity of our second main proposition seems plain from the language of negotiable instruments, but it invariably causes uneasiness; because if it be true, a thief has legal title. This is the acid test to which we shall not delay to submit our theory.

A thief has legal title to a negotiable instrument payable to bearer or indorsed in blank. It is high time to stop being squeamish about this. Other bad men are admitted to have legal title to negotiable instruments, and sometimes to chattels as well, — defrauders, absconding trustees, impersonators. Of course the thief

is, like them, subject to the equities of his victim, but like them he does have legal title.

It is usually assumed that the victim retains legal title after the theft. This cannot be, for the instrument is by its terms payable to bearer and no one who is not a bearer can sue upon it in a court of law. If the thief is bearer but has not legal title, then the legal title has temporarily ceased to exist, for there is no one else to whom the promise runs. Lord Holt put the matter clearly in 1699: "The course of trade . . . creates a property in the assignee or bearer." [28] The *bonâ fide* purchaser from the thief gets the legal title because it was first in the victim and then in the thief and then in the purchaser, passing with the possession. The title did not jump over the thief or pass through some mysterious legal subway. The effect of the *bonâ fide* purchase is not to create a fresh legal title but to cut off the equities of the victim.

The promisee owns the promise and with it the instrument. If the promise runs to bearer, any bearer, however iniquitous, is the promisee, with the legal right to sue and the legal ownership of the paper. If the promise runs to the order of the payee and it appears within the four corners of the instrument that the payee directed payment to a certain indorsee who holds the paper, that person is the promisee, the legal owner, no matter how he obtained the possession.

This result follows after maturity as much as before, since the instrument is just as transferable. The direct promise to the holder remains. The only effect of maturity is, as we have seen, upon the cutting off of equities.

Consequently, payment to the person described by the instrument and producing it to the payor is a valid payment, and the payor is not affected by the wrongful acquisition unless he has notice thereof. The instrument is discharged whether this payment is made at or after maturity.[29] Here is a strong proof that the

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[28] Anonymous, 1 Salk. 126 (1699).

[29] *Payment to one within the description though wrongful owner is a valid discharge.*

At maturity:

Anonymous, Style 366 (1652), time not stated;

Vinson *v.* Vives, 24 La. Ann. 336 (1872), payment to payee, who was subject to equity, time not stated.

Chappelear *v.* Martin, 45 Oh. St. 126, 132, 12 N. E. 448 (1887), *semble.*

Minshall, J.: "Such is the general rule as to the payment of a note payable

wrongful holder has legal title, since payment to a person without legal title, *e. g.* a holder under a forged indorsement, is not a discharge.[30]

Possession plus description equals legal title.

This view runs back to the early cases on negotiable instruments. Lord Holt has already been quoted, and Chief Justice Eyre stated it more fully:

"For the purpose of rendering bills of exchange negotiable the right of property in them passes with the bills. Every holder with the bills takes the property, and his title is stamped upon the bills themselves.

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to bearer; any person having it in possession may be presumed to be entitled to receive payment, unless the payor has notice to the contrary."

Proctor *v.* M'Call, 2 Bailey (S. C.) 298 (1831), *semble.*

Greve *v.* Schweitzer, 36 Wis. 554 (1875), time not stated, bearer note.

After maturity:

Cone *v.* Brown, 15 Rich. (S. C.) 262 (1868), bearer note, paid to agent for safe-keeping.

King *v.* Fleece, 7 Heisk. (Tenn.) 273 (1872), *semble,* order note indorsed in blank, payment in Confederate money to agent for collection after death of principal is good because bearer had legal title; but bad here because payor knew of the agency.

Lamb *v.* Matthews, 41 Vt. 42 (1868), bearer note, paid to holder who had duty to return it to her transferor.

Some of these cases say that the person paid had "authority" to receive the money, but it is clear that no true authority existed.

Contra as to payment after maturity:

Hinckley *v.* Union Pacific, 129 Mass. 52 (1880).

Bainbridge *v.* Louisville, 83 Ky. 285 (1885).

AMES, CASES ON BILLS AND NOTES, II, 822, 854; but Ames is known to have altered his opinion.

These cases, however, rest on another ground as well, that information had been given to the payor of the theft of the instrument. Although the purchaser of an instrument is not affected with notice of a theft because he had previously received information about it, Raphael *v.* Bank of England, 17 C. B. 161 (1855); Lord *v.* Wilkinson, 56 Barb. (N. Y.) 593 (1870); a payor is affected because he may reasonably be required to keep a record of his own outstanding obligations. The cases should properly rest on this ground alone.

The Negotiable Instruments Law prevents any further controversy as to the effect of payment after maturity, for section 119 (1) says, "A negotiable instrument is discharged by payment in due course by or on behalf of the principa debtor;" and section 88, "Payment is made in due course when it is made at or after the maturity of the instrument to the holder thereof in good faith and with out notice that his title is defective." See also section 51.

30 Smith *v.* Sheppard, CHITTY, BILLS (10 ed.) 180, note; S. C. 1 AMES, CASES ON BILLS AND NOTES, 804.

The property and the possession are inseparable. This was necessary to make them negotiable, and in this respect they differ essentially from goods of which the property and possession may be in different persons. The property passing with the possession." [31]

The United States Supreme Court has also stated: "The title and possession are considered as one and inseparable." [32]

Various attacks have been launched against this legal title theory. Thus Ewart says, "Property and possession of bills, as of aught else, are separable; otherwise I could never bring trover for bills against my book-keeper." [33] The reply has been explained already.[34] The plaintiff in trover does not have legal title but recovers on the equitable right to restitution, just like the defrauded seller of goods, whose interest must be only equitable since it can be cut off if the fraudulent buyer sells to a *bonâ fide* purchaser for value without notice.

Another objection is that if the thief had legal title he could sue on the instrument. Two answers are possible. The thief is subject to the true owner's equity of ownership, and in jurisdictions which allow the maker, acceptor, etc., to set up the equity of a defrauded owner, that of a robbed owner could be set up just as well.[35] Some jurisdictions, however, take the sounder view that the *jus tertii*, the right of a person who is not a party to the suit, cannot be set up as a personal defense.[36] Even so, the thief would have no standing in court, on grounds of illegality and public policy, for no court would lend its aid to carry through a crime and enable him to cash in his plunder. Once the thief gets into the purview of justice, the criminal law cuts across the law of property and nullifies the advantages of his legal title, just as it disregards the legal title of the counterfeiter to his plates and acids and hands them over to the police.

A final difficulty in the legal title theory is its inconsistency with

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[31] Collins *v.* Martin, 1 B. & P. 648 (1797).

[32] Clifford, J., in Goodman *v.* Simonds, 20 How. (U. S.) 343, 365 (1857).

[33] Ewart on Estoppel, 394, note.

[34] See discussion on page 1110, and notes 19 and 20.

[35] Eyre, C. J. in Collins *v.* Martin, 1 B. & P. 648 (1797): "This all proceeds upon an *argumentum ad hominem*. It is saying you have the title, but you shall not be heard in a court of justice to enforce it against good faith and conscience." And see the language of Shaw, C. J., in Wheeler *v.* Guild, 20 Pick. (Mass.) 545 (1838).

[36] See page 1141, *infra*, and notes 122, 123 and 124.

the oft-stated doctrine that delivery is necessary to pass title to a negotiable instrument. Since there is no delivery to a thief, legal title must logically remain in the victim instead of passing to the thief. But if this is so, how does it ever get to the *bonâ fide* purchaser from the thief? If delivery is essential to the passage of legal title as a genuine indorsement is essential, then want of delivery would be as fatal as a forged signature. In fact, want of delivery like fraud or any other equity is cut off by transfer to a holder in due course. A plaintiff suing on an instrument need only prove his possession and the genuineness of the indorsements, but not delivery by the indorsers. Legal title to a properly issued negotiable instrument depends upon facts which can be ascertained by inspection of the instrument and identification of the parties, *i. e.*, who possesses it, what is written upon it, who signed it. Extrinsic facts, which cannot be so ascertained, are equities and do not affect holders in due course.[37] A thief has legal title subject to the equity of want of delivery as a defrauder has legal title subject to the equity of fraud. Legal title passes, not by delivery, but by transfer of possession within the terms of the instrument.

It must be admitted that many authorities instead of recognizing this legal title theory, take an alternative view, that the *bonâ fide* purchaser before maturity from a wrongdoer has legal title because the wrongdoer had authority to give it.[38] This implied authority is obviously a fiction just like implied promises in quasi-contract. To say that the Northampton Bank gave any authority to the masked burglars who removed the bonds from its safe on the night of January 18, 1876 to sell those bonds, is as absurd as to declare that the owners of the derelict steamer *Grotkau* in Kipling's "Bread upon the Waters" promised to pay salvage to McPhee, the Scotch engineer who swam over and took her in tow. This assumed agency is only an instance of the judicial tendency to explain results created by law as if they were due to the will of the parties. Instead of looking to the scope of the authority to define the protection afforded the *bonâ fide* purchaser, as we should do in genuine

[37] Want of delivery at the inception of the instrument is a defense in some jurisdictions at common law but not under section 16 of the Negotiable Instruments Law. L. R. A., 1915, E., 351, note.

[38] Marston *v.* Allen, 8 M. & W. 494 (1841).

cases of agency, the courts must necessarily first decide the extent of the protection and then invent an "authority" of equal extent to account for it. And furthermore this artificial authority attributed to the wrongdoer is so much like a legal title subject to equities, that the refusal of the courts to admit such a title recalls the statement in the school-boy's composition, "The Iliad was not written by Homer, but by another man of the same name."

A much sounder theory adopts an agnostic position, rejects this unknowable authority given by nobody, and says that the *bonâ fide* purchaser of a negotiable instrument before maturity is protected because the law thinks him worth protecting, like a purchaser in market overt or under the Factor's Acts. The law of its own volition takes the title out of the victim and puts it into the buyer by an intermediate process which baffles explanation. The wrongdoer is said to have a power to pass title, yet this power is admittedly not given by the victim, but created by law to attain justice. This agnosticism, while honest,. overlooks the express promise on the instrument running o the wrongdoer by virtue of his possession, and furnishes no aid in the different situation of purchase after maturity except that it is a strong analogy favoring the protection of *bonâ fide* purchasers in general. That is to say, the extent of the "power" depends on the justice of the particular case, and when new circumstances are considered, a new "power" must be affirmed or denied to reach a just result in the new situation. The "power" is co-extensive with the protection which the law thinks should be afforded to a *bonâ fide* purchaser.

Apart from this empirical quality of the power theory, it is possible that it is not essentially at variance with the legal title theory. With the disappearance of the division between law and equity, it is probable that the terminology of legal and equitable titles will gradually disappear, and that in the scientific property law of the future, the present equitable title will be regarded as the true ownership of the thing, while the present legal title will be regarded as a power created by law to deal with the thing and not a property right at all.[39] In short, all legal titles are only

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[39] Hodges, J., in Arnold *v.* Southern Pine Lumber Co., 58 Tex. Civ. App. 186, 198, 123 S. W. 1162, 1168 (1909): "Under our system the *cestui que trust* is the real owner of the property, and the trustee merely the depository of the legal title. His is

powers. Whether the wrongdoer's dominion over a negotiable instrument be called legal title or power is perhaps only a matter of terminology. The vital point upon which I insist is that the limits of his dominion are not determined solely by the *ipse dixit* of the law, but by the terms of the instrument. By virtue of those terms this dominion over the instrument, call it what you will, passes with the possession of the instrument to any person within its description, after maturity as well as before, regardless of the manner in which that person obtained his possession. The terms of the instrument prevent an arbitrary termination of the "power" at maturity.

In other words, so long as the advocates of the "power" theory recognize that the holder of an overdue negotiable instrument has the same power that a trustee has of cutting off equitable ownership of the *res*, I need not stop to quarrel with them; but it seems to me more logical and less confusing, so long as the present dual terminology continues in use, to say that both the trustee and the holder to whom the promise runs have a legal title. It is hard to see why if the law can give the thief a power without the consent of his victim, it cannot also give him legal title without consent.

One more theory is presented by Mr. Ewart, [40] who anticipates the main conclusions o this article very closely. I find myself in frequent agreement with him as to details, but not convinced of his fundamental belief that the protection of the holder in due course is based on estoppel.[41] According to his theory, the wrong-

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not a property right, but a legal duty founded upon a personal confidence; his estate is not that which can be enjoyed, but a power that may be exercised."

C. A. Huston, The Enforcement of Decrees in Equity, *passim*, especially page 148: "Had the courts of common law been less entangled in the nets of form — to use the damning phrase of Mansfield — the legal estate of the trustee with its possibilities of injustice might have been reduced to a mere power in law as well as in equity, and the trustee treated there, as on the other side of the court, as the agent which in reality he is."

[40] Ewart on Estoppel, chap. XXIV.

[41] See a review of Mr. Ewart's book in 13 Green Bag, 50.

The broadness of his principle of estoppel is a reason for doubt as to its validity. If the liability of a man who issues a note payable to bearer for $1,000 and of him who issues one for $5, so carelessly written that it is raised to $1,000, are both based on estoppel, we do not get anywhere because we have got to work out two different types of estoppel to explain the results. So with those philosophers who make selfishness the basis of all conduct. The generous man is the most selfish because he gets a higher satisfaction from his self-denial than the man who keeps everything for

doer has not legal title; but his possession is an apparent title, so that the true owner though retaining title is estopped to set it up against a purchaser who relies on the ostensible ownership. Since the wrongdoer's "apparent" title, like his "authority," has all the qualities of a genuine legal title subject to equities, we may conclude with Bishop Berkeley that the appearance is the reality.

With respect to *bonâ fide* purchase before maturity, it is entirely immaterial to the substantial rights of the parties which of these various theories is held. There will be differences as to pleading and burden of proof, but the holder in due course will always be protected from equities of both kinds on any theory. It is the abnormal situation, dishonor, which forces us to choose between the various views, and in particular reveals the serious difficulties of the orthodox authority doctrine.

The previous discussion may be summed up as follows. Transfer to a *bonâ fide* purchaser for value without notice and within the terms of the instrument has three results before maturity:

1. It passes legal title with the possession.
2. It cuts off equitable claims to the ownership of the paper.
3. It cuts off equitable defenses to the liability of parties on their contracts.

The first result follows equally by a similar transfer after maturity. Our remaining task is to explain why the second result should also continue, while the third is no longer effected.

II. The Distinction Between the Two Classes of Equities After Maturity

Apart from questions of notice the *bonâ fide* purchaser after maturity of a negotiable instrument, since he has legal title, should be protected from equitable claims to ownership just like the *bonâ*

himself. So be it — but if the man who waits on a sinking steamer until all the women and children are put off is as selfish as the man who jumps into the first life boat and stays by main force, we have solved nothing, for we must find some way to create more of the first kind of selfishness and less of the second.

No doubt a policy similar to that on which estoppel by reliance on special situations rests underlies the law as to the general operation of negotiable instruments, that is, the policy in favor of the security of *bonâ fide* transactions. But it is better to limit the term estoppel to abnormal situations where the truth cannot be set up because of misconduct.

fide purchaser for value of any other chattel, who of course takes free from the equities of a *cestui que trust*, defrauded seller, etc. Even if an overdue instrument be regarded as a non-negotiable chose in action, instead of a chattel, the same result will follow. Several courts [42] protect the *bonâ fide* purchaser after maturity on the basis of Chancellor Kent's doctrine in *Murray* v. *Lylburn*,[43] that the assignee of a chose in action takes subject to the equities of the obligor but not to "latent" equities. The same view was held by Ames, that the assignee having a legal power should be protected in his ownership of a chose in action.[44] If this protection is given to the assignee of a chose in action, it should certainly be given to the holder of an overdue negotiable instrument (always on the assumption that maturity is not notice of these "latent" equities). It is true that *Murray* v. *Lylburn* is rejected in many jurisdictions, including New York;[45] and the case has been criticised on the grounds that the assignee of a chose in action has only an equitable interest and that the *bonâ fide* purchaser of an equitable interest is not entitled to protection against prior equities.[46] We need not launch out upon that stormy sea. The objections to Kent's doctrine do not apply to the holder of an overdue instrument, because he has legal title and consequently is within the scope of the principle that where equities are equal the legal title prevails. Consequently Mr. Williston, in arguing that the assignee of an ordinary chose in action has only an equitable interest, believes that the holder of an overdue instrument should take free from equitable claims to ownership.[47]

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[42] National Bank *v.* Texas, 20 Wall. (U. S.) 72, 88, (1873) per Swayne, J.; Mohr *v.* Byrne, 135 Cal. 87, 67 Pac. 11 (1901); Crosby *v.* Tanner, 40 Iowa, 136 (1874); Hibernian *v.* Everman, 52 Miss. 500 (1876).

[43] 2 Johns. Ch. (N. Y.) 441 (1817).

[44] "Purchase for Value without Notice," 1 HARV. L. REV. 1; LECTURES ON LEGAL HISTORY, 254; CASES ON TRUSTS, 309, 310, the notes to Cave *v.* Mackenzie, 46 L. J. (Ch.) 564 (1877).

[45] 30 HARV. L. REV., 103, note 10; Williston's Wald's Pollock on Contracts, 284, n. 78.

[46] "Is the Right of an Assignee of a Chose in Action Legal or Equitable?" Samuel Williston, 30 HARV. L. REV. 97, 102. For other articles by Mr. Williston and Mr. Walter Wheeler Cook on this question see 29 HARV. L. REV. 816; 30 HARV. L. REV. 449; 31 HARV. L. REV. 822.

[47] 30 HARV. L. REV. 103: "A distinction must be taken where the chose in action has a tangible form, especially if it is by law assignable. The assignment of an overdue negotiable promissory note though often likened to that of an ordinary chose in action

A pertinent question here presents itself. Are equities really equal? It is clear that they are not if the purchaser takes with notice of the equitable claims to ownership. It will be urged that maturity is equivalent to such a notice, that after that critical day an overdue instrument has no right to be in circulation at all. The fact that it is overdue is like a red flag which gives warning of every conceivable kind of danger and puts the purchaser on inquiry as to all infirmities without distinction. This is clearly going too far. It is well settled that certain defenses on the instrument are not let in after maturity. For example, in England and a large number of States a set-off does not run against the purchaser. In many jurisdictions the defense of accommodation is cut off by a transfer after maturity. Evidently maturity does not force the purchaser to proceed at his peril and make him voluntarily assume all risks. A particularly interesting example of the principle that a purchaser after maturity does not thereby become a purchaser with notice of all unknown defects is furnished by the case of *Re Clover*.[48] A New York statute provided for proceedings against a judgment debtor supplementary to execution, and the appointment of a receiver who was given title to all personal property in the hands of the debtor at the time when he was ordered to attend for examination concerning his property. But the statute did not affect the "title of a purchaser in good faith, without notice, for a valuable consideration." After the service of the order upon the judgment debtor, he transferred overdue negotiable notes to a purchaser for value without actual notice. The receiver contended that the immunity clause would not enable the purchaser to keep the notes, because maturity prevented him from being "without notice" and the fact that the paper was overdue put him upon inquiry as to what, if any, defenses, liens or equities existed. According to him, the purchaser of an overdue instrument is in a worse position

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does not properly involve such a discussion as is contained in this article. Even after maturity the transfer of such a note by the holder unquestionably transfers a legal title and though the circumstance that the transfer is after maturity puts the taker of the note on inquiry as to any defense the maker may have (since if he had had no defense the instrument would presumably have been paid) yet the fact that the instrument is overdue gives no reason to suppose that there are collateral equities affecting the transferor's title. In such a case, therefore, the *bonâ fide* purchaser of the note is protected."

[48] 8 App. Div. (N. Y.) 556; 154 N. Y. 443 (1897).

than the assignee of an ordinary chose in action which has no maturity to put the purchaser on inquiry. Both the Appellate Division and the Court of Appeals rejected this distinction and decided against the receiver, holding that maturity did not *ipso facto* create notice or bad faith, but was at most only evidence bearing upon the question of good faith, so that this purchaser was without notice and took the notes free from the creditor's lien. Martin, J., said:

"It is true that all of the notes purchased, except one, were past due, yet that fact was in no way inconsistent with a good title in the holder or with his right to transfer them. . . . The fact that most of the notes had previously matured would not naturally have indicated that the holder was not the owner, nor would it have suggested that any proceeding was pending against him which would affect his title." [49]

The same reasoning applies to all equities of ownership. Maturity indicates nothing about them. Instead of being a red flag to give warning of all hidden dangers, it resembles more closely a printed placard calling attention to one special peril. A person approaching a grade-crossing and seeing the sign, "Stop, Look, and Listen," is bound to watch for trains, but he does not assume the risk of a savage bull-dog maintained on the railroad right of way to scare off track-walkers.

At this point it is necessary to keep the distinction between the two classes of "equities" firmly in mind. Equitable defenses are let in after maturity for a good reason, but that reason does not apply to equitable claims to ownership.

The rule that a purchaser of overdue paper takes subject to equitable defenses was established in England comparatively late,[50] largely by the influence of Justice Buller, and was accepted with reluctance in 1789 by the Court of King's Bench.[51] Even then, Chief Justice Kenyon doubted its validity, and concurred with the other judges only because he thought that there was actual notice. There is much vague explaining in these early cases, that transfer after maturity gives rise to suspicion and is out of the common

[49] 154 N. Y. 443, 448 (1897).

[50] In Banks *v.* Colwell (1788), cited in 3 T. R. 81, Justice Buller said that it had been repeatedly ruled at Guildhall that the indorsee after maturity was subject to equitable defenses. And see 3 T. R. 83, (1789) note. Brown *v.* Davies seems to have been the first case decided *en banc.*

[51] Brown *v.* Davies, 3 T. R. 80 (1789). For Kenyon, see also Boehm *v.* Sterling, 7 T. R. 423, 429 (1797). And see the discussion of the Civil Law in note 131, *infra.*

course of dealing. Overdue paper is often said not to be commercial paper at all,[52] with entire disregard of the frequency with which it is bought and sold. Such general statements are responsible for the frequent judicial hostility toward overdue paper, and the desire to subject it to all infirmities and not merely to equitable defenses.

Fortunately Chief Justice Shaw has put the rule as to equitable defenses on a definite and rational basis:[53]

"The question instantly arises, Why is it in circulation, — why is it not paid? Here is something wrong. Therefore, although it does not give the indorsee notice of any specific matter of defense, such as set-off, payment, or fraudulent acquisition, yet it puts him on inquiry."

Other judges state the reason for constructive notice well:

"Ordinarily a bill or note when due becomes *functus officio*, because it was made to be paid at maturity, and if it fails of its intended operation and effect, the presumption is that it is owing to some defect which has furnished a sufficient reason to the party apparently chargeable for not having punctually performed his obligation."[54]

"The bare fact that a negotiable instrument is unpaid at its maturity, is a circumstance sufficient to raise the presumption of fraud, and that there exists some valid legal reason why it was not paid. The law of merchants being the law of honor, all bills and notes . . . it is presumed, will be promptly paid."[55]

Therefore, because all the contracts on the instrument would naturally be performed at maturity, the equitable defenses of all parties are let in after maturity. It is certain that the primary party to the instrument can set up such defenses, and the peculiar doctrine of a recent Washington case that only equities against the payee run after maturity, so that payment to an indorsee is no defense against the *bonâ fide* purchaser, is indefensible.[56] On

[52] Thomas *v.* Kinsey, 8 Ga. 421, 433 (1850); Chester *v.* Dorr, 41 N. Y. 279 (1869); Etheridge *v.* Gallagher, 55 Miss. 458, 467 (1877); Henderson *v.* Case, 31 La. Ann. 215, 216 (1879); Greenwell *v.* Haydon, 78 Ky. 332, 347 (1880); Midland *v.* Hitchcock, 37 N. J. Eq. 549, 558 (1883).

[53] Fisher *v.* Leland, 4 Cush. (Mass.) 456 (1849).

[54] Morgan *v.* United States, 113 U. S. 476, 500 (1885) per Mathews, J.

[55] Davis *v.* Bradley, 26 La. Ann. 555, 556 (1874) per. Taliaferro, J. Unfortunately this case and the preceding do not realize that the reason stated limits the effect of constructive notice to equitable defenses only.

[56] Reardon *v.* Cockrell, 54 Wash. 400, 103 Pac. 457, 50 L. R. A. (N. S.) 87 (1909). *Held*, the maker cannot set up a part payment to the first indorsee who was then

principle, a secondary party who is sued by an indorsee after maturity ought also to be able to avail himself of any equities of his own, although it is sometimes suggested that only the equities of the primary party run.[57] Of course the failure of an indorser to pay the instrument is a much weaker evidence of defenses than dishonor by a maker or acceptor, yet it would be natural for the indorser to take it up and protect his credit unless he felt sure of defeating an action against him. A secondary party expects to pay at maturity if at all and safeguard himself then, by recourse to the primary party, so that transactions after maturity should not cut off defenses which he had at maturity. Such a result would be highly prejudicial to him, forcing upon him the choice of taking up at maturity an instrument on which he has a defense or of running the risk of subsequent liability to a *bonâ fide* purchaser. Furthermore, "the maker often signs for accommodation, and the apparent indorser may be principal." [58] It would be especially unjust in such a case if the indorser's defenses could be cut off, for he would have no recourse against the maker. There is very little authority, but this except for three cases supports the conclusion just reached.[59] It is hardly necessary to add that secondary parties

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holder. See also Wynn *v.* Kelly, 22 La. Ann. 594, 595 (1870). The cases cited in Reardon *v.* Cockrell and the L. R. A. note thereto as in accord are all with the possible exception of Vinton *v.* Crowe, 4 Cal. 309 (1854), set-off decisions, which do not necessarily apply to other equities, set-off being a procedural matter depending on statute and no defense (even if against the payee) to a purchaser after maturity in England and many states.

Contra to Reardon *v.* Cockrell; Eaton *v.* Corson, 59 Me. 510 (1871), payment; Bond *v.* Fitzpatrick, 4 Gray (Mass.), 89 (1855), payment or equitable discharge.

The cases holding that a set-off of the maker against an indorsee is a defense would *a fortiori* allow other defenses between maker and indorsee. Harris *v.* Burwell, 65 N. C. 584 (1871); Wyman *v.* Robbins, 51 Ohio St. 98, 37 N. E. 264 (1894).

It is possible that the doctrine of Reardon *v.* Cockrell can be traced to STORY ON PROMISSORY NOTES (6 ed.), § 178: "If the transfer is after the maturity of the Note, the holder takes it as a dishonored Note, and it is affected by all the equities between the original parties."

[57] This seems to be the view of Francis R. Jones in his article in 11 HARV. L. REV. 40; see page 42, top. It is also held by Hill *v.* Shields, 81 N. C. 250, 253 (1879); Parker *v.* Stallings, Phil. L. (N. C.) 590 (1868); Sanderson *v.* Crane, 2 Green (14 N. J. L.), 506, 509 (1834).

[58] Zeis *v.* Potter, 105 Fed. 671, 675 (C. C. A. 7th, 1901).

[59] *Equitable Defenses of Secondary Parties run after Maturity.*

Drawer: Serrell *v.* Derbyshire, 9 C. B. 811 (1850), *semble;* Rounsavel *v.* Scholfield, 2 Cranch, C. C. 139 (U. S.) (1817); Skillman *v.* Titus, 32 N. J. L. 96 (1866);

can always set up want of presentment and notice against a purchaser after maturity.

A distinction must be taken between the defenses of parties who become liable before maturity and after maturity. The instrument takes a new lease of life with respect to an indorser after maturity, and his equitable defenses are not let in until a reasonable time after he indorses, although the paper is apparently overdue.[60] The same is true of a drawer [61] or even a maker or acceptor who becomes bound after the date of payment. The promise is to pay on demand.[62] A contract made after maturity has a special maturity of its own, *i. e.*, a reasonable time after execution, and *bonâ fide* purchasers within that time will be protected from all equities of the party who signed, even equitable defenses.

It must also be remembered that the defendant can set up only his own equities when sued by a purchaser after maturity. Thus an indorser cannot set up the defenses of a maker or prior indorser, because he has made a fresh promise. Nor can a maker set up fraud upon an indorser because that is not an equitable defense on the maker's contract, and though the indorser has an equity of ownership, it was cut off by the *bonâ fide* purchase even though the latter was after maturity.[63]

It is clear from the preceding discussion and especially from the language of Chief Justice Shaw and the other judges quoted that a purchaser after maturity is put on inquiry as to equitable

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Bridgford *v.* Crocker, 3 Th. & C. (N. Y.) 273 (1874); Cowing *v.* Altman, 1 Th. & C. (N. Y.) 494 (1873); Lancester *v.* Woodward, 18 Pa. St. 357 (1852).

Indorser: Crossley *v.* Ham, 13 East. 498 (1811); Chester *v.* Dorr, 41 N. Y. 279 (1869). *Contra*, Wynn *v.* Kelly, 22 La. Ann. 594 (1870); but the defense here was collateral, like set-off; Hill *v.* Shields, 81 N. C. 250 (1879); indorser after maturity, and purchase may have been within a reasonable time, but the opinion allows only maker's equities to run; Parker *v.* Stallings, Phil. L. (N. C.) 590 (1868).

60 An indorser after maturity is held to be liable only for the price paid him, in McAdam *v.* Grand Forks, 24 N. D. 645, 140 N. W. 725 (1913), *sed quaere.*

61 Boehm *v.* Sterling, 7 T. R. 423 (1797).

62 NEGOTIABLE INSTRUMENTS LAW, § 7, enacts the common law; "Where an instrument is issued, accepted, or indorsed when overdue, it is, as regards the person so issuing, accepting, or indorsing it, payable on demand."

63 An accommodation indorser, being a surety, can set up the equitable defense of his principal, the maker. Livermore *v.* Blood, 40 Mo. 48 (1867).

The difficult question whether jurisdictions which hold that equities of ownership are *not* cut off after maturity should allow such equities to be set up as defense by a prior party is discussed on page 1141, *infra*. See notes 122, 123, 124.

defenses. But his duty to inquire stops there. The reasoning of the courts does not apply to equities of ownership. The effect of maturity as notice is limited by the fact that maturity does not terminate the life of a negotiable instrument as property. Equities of ownership relate to the instrument as property, but maturity, like equitable defenses, relates to liability on the contracts. It is a term of the respective promises of the parties. The possession of an overdue instrument is a clear indication that there is something the matter with the promises, whether it be a defense or only financial embarrassment or procrastination, but it does not indicate in any way that the possessor wrongfully acquired the instrument from a previous owner. Maturity has an obvious relation to liability on the contracts, and therefore brings into play the equitable defenses which prevent liability. But maturity has no effect upon the existence of the instrument as a thing of value, or its transferability. It is a chattel as before, legal title passes as before, and equities of ownership are cut off by purchase of the legal title for value without notice just as in the case of any other chattel. The purchaser must ask why the instrument was not paid, or take the risk that there may have been a good reason for default, but nothing has happened to make him ask why the transferor instead of some other man has the instrument. Consequently, on correct principles, the purchaser after maturity, unless sheltered under the title of a preceding holder in due course, cannot sue upon any contract as to which there is an equitable defense, but can keep the instrument and sue on contracts which are free from such defenses. Maturity alters contracts which are subject to defenses, crystallizing the defenses, as it were, but contracts not subject to defenses continue as before. The *bonâ fide* purchaser after maturity gets the instrument as it is and owns each contract for better, for worse.

This solution of our problem, that equities of ownership are still cut off after maturity but equitable defenses run after maturity, has been ably presented in the recent Federal case of *Wolf* v. *American Trust Company*:[64]

"An indorsement of a negotiable instrument to a named indorsee has two aspects. In one, it is a contingent contract of debt as complete

[64] 214 Fed. 761, 765 (C. C. A. 7th, 1914) per Baker, J.

and definite as if the terms thereof were written out in full above the indorser's signature; and in the other, it is a conveyance to the indorsee of the legal title to the instrument considered as a species of property — as perfect a conveyance as is the ordinary bill of sale of the ordinary chattel. Concerning the indorser's liability on his contingent contract of debt, the maturity of the instrument may or may not be important. As to the validity of the indorser's conveyance of the legal title, the maturity of the instrument is inconsequential. And so in this case, inasmuch as appellee is not counting on appellant's contingent contract of debt but is only asking him to respect his conveyance of the legal title, the principle applies, which is common to the law of all kinds of property, that the innocent purchaser of the legal title is protected again t secret equities respecting the title."

III. Alternative Views of Overdue Paper

The preceding portion of this article solves the problem of the *bonâ fide* purchaser after maturity in accordance with what is believed to be the true theory of negotiable paper, which involves (1) the classification of equities and (2) the passage of legal title to the possessor within the description of the instrument. Other theories as to negotiable instruments have been mentioned, and we must now consider the consequences of the application of these theories to overdue paper, and the views actually adopted by the courts in overdue paper cases.

The estoppel theory reaches the same conclusions as this article by a different course of reasoning as to legal title and the same views as to the two kinds of equities.[65] As Mr. Ewart forcibly expresses it:

"The holder of a bill to bearer appears to be the owner of it —

[65] Ewart on Estoppel, 423–24.

"Apart from any asserted *ipse dixit* of the law merchant, the only reason for declaring that the holder of an overdue bill or note takes it subject to equities is that he has notice that payment has been refused; this refusal may have been because of the existence of equities; the purchaser should have inquired; if he had he would have discovered equities; he therefore takes with notice actual or constructive of them, and for that reason ought to hold subject to them. . . .

"But we must remember a distinction. The equities of which a transferee is relieved are (1) the equities of the obligors, and (2) the equities of the true owner of the document — or rather the legal title of this true owner. Now the reason for cutting out equities applies very forcibly to the former of these cases; but it has no relation to the latter."

The rest of the passage is quoted in the text above, and in note 99, *infra*.

'the property and the possession are inseparable.' Due or not due does not affect or modify this appearance. The true owner is as much estopped by ostensible ownership of a dead horse (overdue as we may say) as of one still able to trot."

The decisions with regard to overdue paper are much influenced, however, by a very different doctrine from the legal title theory or Mr. Ewart's estoppel theory. This doctrine denies that the wrongful possession of negotiable paper necessarily confers a real or apparent legal title; the wrongdoer, especially if a thief, has only an authority or power to pass title, which terminates abruptly at maturity. After that period, the paper is said to be subject to a general rule that title cannot pass without the consent of the owner. This doctrine also ignores the distinction between equitable defenses and equitable claims to ownership, lumping them all together as "equities." The result is a strong body of judicial opinion, which takes the red flag view of maturity and regards it as warning the purchaser of everything that is wrong about the instrument. This view has long been held in England [66] and is codified by the Bills of Exchange Act, 1882:[67] "Where an overdue bill is negotiated, it can only be negotiated subject to any defect of title [68] affecting it at its maturity, and thenceforward no person who takes it can acquire or give a better title than that which the person from whom he took it had."

This English view, as we may call it, is evidently at the opposite pole from the view advocated in this article. Instead of protecting the *bonâ fide* purchaser from all claims to the ownership of the instrument, it subjects him to all such claims, whether made by indorsers, prior owners who did not indorse, or persons who never had any possession of the instrument, and whether the wrongdoer be a thief, a defrauder, or an absconding custodian.

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[66] *In re* European Bank, L. R. 5 Ch. App. 358 (1870). [67] § 36 (2).

[68] CHALMERS ON BILLS OF EXCHANGE (7 ed.), page 129, says that "defect of title" was used to mean "equity attaching to the bill," since that term was unknown in Scotch law, and the Act extended to Scotland. The Scotch law did not subject the *bonâ fide* purchaser after maturity to equitable claims or defenses until Parliament applied the English rule to Scotland in 1856. Mercantile Law (Scotland) Amendment Act, 19 and 20 Vict. c. 60, § 16: "When any Bill of Exchange or Promissory Note shall . . . be indorsed after the Period when such Bill of Exchange or Promissory Note became payable, the Indorsee of such Bill or Note shall be deemed to have taken the same subject to all Objections or Exceptions to which the said Bill or Note was subject in the Hands of the Indorser." See note 117, *infra*.

Although many American courts give apparent allegiance to this doctrine and have adopted its catch-words, that an overdue instrument is mere personal property, title to which cannot pass without the consent of its owner, so that the paper is bought after maturity subject to all infirmities,[69] nevertheless the English view is so harsh upon innocent purchasers that our judges shrink from applying it, at least in its extreme form. Consequently the American law inclines to protect the *bonâ fide* purchaser after maturity, although the authorities are by no means harmonious. The complete protection advocated in this article is not given by any State with the probable exception of North Carolina,[70] but in view of the strong statement of the Circuit Court of Appeals in the Seventh Circuit in *Wolf* v. *American Trust Company*[71] and the concurring opinion of Justice Swayne in *National Bank* v. *Texas*[72] in the Supreme Court, it is possible that the Federal courts will eventually cut off all equities of ownership. And in most States it is certain that there are circumstances under which the *bonâ fide* purchaser will get a good title, although the decisions differ very much as to what those circumstances are.

We can roughly place the cases in three divisions, according to the grounds on which they cut off equities of ownership. These grounds are not mutually exclusive. A jurisdiction may cut off equities on all three grounds, or it may recognize only one ground and repudiate the others, and so forth. If it cuts off equities at all, it leans in the direction of the conclusions of this article, although it may draw the line at a point which seems questionable.

1. The first view determines whether protection shall be given to the *bonâ fide* purchaser after maturity by the manner in which the wrongdoer acquired possession of the instrument from his victim. Where the owner purposely transfers the paper under circumstances which enable his transferee to deal with it as if he were the true owner, the transferee can give a good title. Either he is said to have legal title subject to equities which cannot be

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[69] See, for example, the cases in note 52, and also Wood *v.* McKean, 64 Iowa, 16 (1884).

[70] Parker *v.* Stallings, Phil. L. (N. C.) 590 (1868); Hill *v.* Shields, 81 N. C. 250 (1879); Bradford *v.* Williams, 91 N. C. 7 (1884). The first two cases go even farther than this article and cut off equitable defenses of an indorser.

[71] 214 Fed. 761 (1914), quoted on page 1126, *supra*.

[72] 20 Wall. (U. S.) 72, 88 (1873).

set up,[73] or else though he has not title the true owner by conferring on him the *indicia* of ownership is estopped from disputing the rights of the purchaser who has been misled.[74] Usually these two arguments are mingled without discrimination. On this view the purchaser from a thief or finder would not be protected,[75] either because no legal title passes with this kind of transfer, or because legal title never passes to a wrongdoer after maturity and in these cases the true owner is not estopped to set up the wrong. This voluntary transfer view has the largest judicial support of any ground for protection of the purchaser after maturity. It is adopted in many cases,[76] and although there are numerous decisions which allow the owner who voluntarily parted with overdue paper to regain it,[77] the estoppel point was not raised, or else the court recognized the validity of the principle of estoppel but held it was not created by the facts of the particular case.[78] On the other hand, there is no instance of involuntary transfer by the owner where the *bonâ fide* purchaser was actually protected by a court,[79] unless we except *National Bank* v. *Texas*.[80] The purchaser from a thief or finder gets his only encouragement from dicta and legal reasoning. The voluntary transfer view consequently takes its stand at the high-water mark of judicial protection for the *bonâ fide* purchaser after maturity.[81]

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[73] Morton, J., in Gardner *v.* Beacon Trust Co., 190 Mass. 27, 30, 76 N. E. 455 (1906), citing White *v.* Dodge, 187 Mass. 449, 73 N. E. 549 (1905), which practically adopts the legal title theory, since it compares the wrongful transfer to the conveyance of a stock of goods which the vendor had obtained by fraud. Gardner *v.* Beacon itself practically rejects the view that maturity gives notice of equitable claims, though in the same breath it says the purchaser is subject to all equities. Morton, J., shrank from the plunge.

[74] Young *v.* MacNider, 25 Can. S. C. 272, 279 (1895), per Strong, C. J.

[75] See the dicta as to theft and finding in cases which recognize voluntary transfer as a ground of protection, Appendix, Group B 4.

[76] Appendix, Groups A 2 and A 3, except Wolf *v.* American, and the first two North Carolina cases.

[77] Appendix, Groups B 5, 6, 7.

[78] Osborn *v.* McClelland, 43 Ohio St. 284 (1885), and the Illinois cases against the *bonâ fide* purchaser.

[79] Appendix, Groups B 1, 2, 3.

[80] See Appendix, Group A 1.

[81] The voluntary transfer view in its most liberal form corresponds with the protection given to the *bonâ fide* purchaser for value of a document of title by the Uniform Sales Act, § 38 and the Uniform Warehouse Receipts Act, § 40. It is significant that the Uniform Bills of Lading Act, §§ 31, 32, and the Uniform Stock Transfer Act, § 5, protect even the purchaser from a thief.

In spite of the fact that this view reaches a just result in a large number of cases, it is open to two serious objections. First, it separates the possession of the instrument from the power to give a good title, unless it can find some consent on the part of the true owner. Since the last thing that owner really wants is to be deprived of his property wrongfully, the interpretation of his mental attitude becomes a difficult and arbitrary matter. The "authority" given by him to the wrongdoer was wholly fictitious before maturity, and is still far from genuine after the paper is overdue. A Rhode Island court once allowed a will to be completely rewritten after the testator's death by the consent of all the persons interested, and then set itself to construe certain ambiguous passages in the new document and find out "the intent of the testator." Courts which adopt the "authority" theory are similarly embarrassed in their efforts to ascertain the transferor's intention.

Consequently the courts do not agree as to the kind of voluntary transfer which will pass title to the wrongdoer or estop the owner. If consent is obtained by fraud, Indiana, Massachusetts, and Minnesota protect the purchaser,[82] while Illinois and Mississippi class the defrauder with a thief,[83] saying that no title whatever passes, and that even if *bonâ fide* purchase after maturity cuts off equities it does not cut off the legal title. Once the Illinois court had gone outside the four corners of the instrument and announced that the will of the victimized owner must be taken into consideration, it began to draw very fine distinctions to determine whether or not the wrongdoer was "clothed with the *indicia* of title." The result of the Illinois cases is that a pledgee [84] or an agent for safe-keeping and receipt of interest [85] is *purposely* given title, but an agent for renewal is not.[86] Offhand, we should expect the distinction, if

[82] Moore *v.* Moore, 112 Ind. 149, 13 N. E. 673 (1887); Gardner *v.* Beacon, 190 Mass. 27, 76 N. E. 455 (1906); Cochran *v.* Stewart, 21 Minn. 435 (1875).

[83] Etheridge *v.* Gallagher, 55 Miss. 458, 469 (1877); Y. M. C. A. *v.* Rockford, 179 Ill. 599, 604, 54 N. E. 297 (1899); citing Henderson *v.* Case, 31 La. Ann. 215, 216 (1879), in which Spencer, J., said: "We do not think that the authorities citied by defendant to the effect that 'no collateral equities can effect an assignee of commercial paper transferred after maturity' can be applied to the case where there is a *total want of right* in the transferor."

[84] Y. M. C. A. *v.* Rockford, 179 Ill. 599, 54 N. E. 297 (1899).

[85] Justice *v.* Stonecipher, 267 Ill. 448, 108 N. E. 722 (1915, under N. I. L.).

[86] Hide *v.* Alexander, 184 Ill. 416, 56 N. E. 809 (1900); Merchants *v.* Welter, 205 Ill. 647, 68 N. E. 1082 (1903). See also Osborn *v.* McClelland, 43 Ohio St. 284, 1 N. E. 644 (1885).

there is any, to be just the other way; for the authority to collect small amounts of interest is much narrower than the authority to surrender the instrument itself and take another with a later time for payment.

If estoppel be the ground of these cases, the apparent ownership of the wrongdoer and the reliance of the purchaser are just the same, however the owner lost possession. There is no real basis for an estoppel in these cases except the mere possession of the wrongdoer, and that exists regardless of delivery. If an overdue instrument is only a chattel, estoppel is surprising, for possession of other chattels does not *per se* create estoppel; but if estoppel is created by the possession, it ought to exist in all cases of possession, without these fine distinctions as to the owner's mental attitude and consent.

If passage of title be the ground of these voluntary transfer cases, then title ought to pass whether the victim consents or not, just as before maturity. There is no true consent to be deprived of his ownership in any case. The limits of the wrongdoer's power are fixed by law and the terms of the instrument. The attempt to define them by the intention of the victim only results in uncertainty. There is no reason in nature for giving a thief less power to pass title than a cunning swindler or an embezzler, and as for the finder, it is hard to see why he should be classed with a thief at all.[87] Since a finder's possession entitles him to sue, like the chimney-sweep who discovered the jewel,[88] the finder of a negotiable instrument payable to bearer has before maturity every incident of legal title, and maturity should have no effect on his legal title, especially as he is not a wrongdoer. After maturity he ought to be in as good a position as the agent for collection, who can admittedly cut off the true owner's equities by virtue of his legal title. And when the courts say that there is no intention to pass title to a defrauder or an agent for renewal or an accommodated friend, we have confusion worse confounded.

A second difficulty about the voluntary transfer view is its inability to decide whether maturity is or is not constructive notice of claims of

[87] The only case as to a finder seems to be Vairin *v.* Hobson, 8 La. 50 (1835), denying protection to the *bonâ fide* purchaser, but the dicta in Appendix, Group B 4, class a finder with a thief.

[88] Armory *v.* Delamirie, 1 Stra. 505 (1722).

ownership. If maturity is not such notice, then the *bonâ fide* purchaser ought to be protected in all cases, as I contend. If it is notice, it puts the purchaser on inquiry in all cases, and there can be no estoppel, since estoppel presupposes justifiable reliance. The purchaser is not misled to overlook the danger, since the red flag of maturity waves before his eyes. Consequently it is incorrect for the voluntary transfer cases to seek support as they often do from *McNeil* v. *Tenth National*,[89] and similar decisions,[90] which protect from equitable claims of ownership the *bonâ fide* purchasers of tangible choses in action like stock certificates and insurance policies, on the ground that the true owner is precluded by his conduct from asserting his title. Such instruments have no maturity to give warning of defects of title. The analogy is proper only if you limit the effect of maturity to equitable defenses. These voluntary transfer cases let in all equities at the front door and then try to shut them out at the back.

The objection was well put by counsel in a Maryland case:[91]

> "The intervention of the equitable principle that 'where one of two innocent parties must suffer, *he* must suffer who misled the other, cannot be successfully invoked by the [purchaser after maturity], because he is not, in the eye of the law, an innocent party. [His] position is worse than that of an assignee of a mere *chose in action* under similar circumstances, for the fact that the note was overdue when transferred to him is of itself *notice* of the fraud, and of the consequent defect in [his transferor's] title. How can a *particeps fraudis* take advantage of this equitable principle?"

Most of the voluntary transfer cases start with the assumption that the purchaser of an overdue instrument takes it "subject to all the equities attached to it." If so, he is not a *bonâ fide* purchaser without notice and ought not to have the benefit of any estoppel or take free from the very equities to which *ex hypothesi* he is subject.

The only way to reach a sound result is to recognize squarely that maturity has nothing to do with equities of ownership. The

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89 46 N. Y. 325 (1871). It is important to remember that this case rests upon estoppel and not upon Kent's latent equity doctrine, which is overruled in New York.

90 30 HARV. L. REV., 104 notes 14, 16, and 17; Williston's Wald's Pollock on Contracts, 294, note 88.

91 Eversole *v.* Maull, 50 Md. 95, 97 (1878).

difficulties of the voluntary transfer view arise from its reluctance to adopt the two fundamental propositions, that there are two kinds of equities, and that the capacity to give a perfect title passes with possession within the terms of the instrument.

2. A second view rejects the English rule that the equities of all persons run after maturity, and lets in only the equities of those persons of whom the prospective purchaser can fairly be required to make inquiry. Thus, it would be extremely harsh to subject him to the claims of persons whose names do not appear on the instrument, who never had possession of it, and were not in the chain of title at all. It is plain that unlimited diligence on the prospective purchaser's part would probably fail to disclose such claims. As Chancellor Kent puts it,[92] "He has not any object to which he can direct his inquiries." Questions addressed to the transferor will hardly elicit the fact that he is a defaulting trustee or obtained the instrument in fraud of the creditors of a prior holder. Yet by the English view, the *cestui que trust* or the creditors could get the instrument from the purchaser. In the leading English case,[93] the agent of a bank wrongfully used its funds to buy overdue bills, which he sold to an innocent buyer. The bank's claim was undiscoverable, for the only person who knew of it, the agent, would not have revealed his misconduct, yet the bank prevailed. There are several cases in this country which refuse to let in such "latent" equities,[94] although authority the other way is not lacking.[95] Since there is no voluntary transfer in most of these cases, there would be no chance to work out an estoppel[96] if the latent equity view be rejected.

It is possible to extend this latent equity view even farther and protect the *bonâ fide* purchaser from the equities of prior owners if the instrument was payable to bearer or indorsed in blank before they acquired it. Their names do not appear on the paper, and it is only by a series of tedious inquiries that he can discover who they are. "It would even be impracticable, if not wholly impossible, for the last purchaser to investigate the history of the note suffi-

[92] Murray *v.* Lylburn, 2 Johns Ch. 441, 443 (1817).

[93] *In re* European Bank, L. R. 5 Ch. App. 358 (1870), equities of undisclosed principal.

[94] Appendix, Group A 4.

[95] Appendix, Group B 8.

[96] Turner *v.* Hoyle, 95 Mo. 337, 8 S. W. 157 (1888). See, however, Young *v.* MacNider, 25 Can. S. C. 272 (1895).

ciently to ascertain the names of all the persons through whose hands it had passed, where . . . it had been transmitted by delivery and not by indorsement. An intending purchaser, recognizing the difficulty and his liability to adverse demands . . . , would wisely refuse to have anything to do with such paper at all." [97] It is also plain that there is no duty to ask such persons about equitable defenses and incidentally learn of equities of ownership. Where a man is under no obligation to pay at maturity, the fact that the instrument is unpaid has nothing to do with him.[98] Consequently, there is a strong argument for cutting off the equities of prior owners who have not indorsed.[99] But no case protects the purchaser on this ground, and there is an overwhelming body of decisions which subject him to such equities.[100] Indeed, some of the cases find it easier to cut off a former owner who has indorsed, saying that the signature is one more element to indicate passage of title and create an estoppel.[101]

It is regrettable that there has not been more discussion in the cases [102] of this position, that a purchaser after maturity takes

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[97] Sykes Banking Co. *v.* Morris, 2 Tenn. Ch. 236, 241 (1901), holding that set-offs against an intermediate holder do not run.

[98] It is by no means certain that inquiry of the person who has the equitable claim will reveal it. The owner may not be aware of the fraud at the time of the purchase. See Proctor *v.* McCall, 2 Bailey (S. C.), 298, 302 (1831).

[99] EWART ON ESTOPPEL, 423: "The holder of an overdue note payable to bearer offers it for sale; the intending transferee inquires of all persons liable upon the note as to equities or claims, and is told that there are none; he then buys the note; afterwards some stranger demands it from him, saying that the transferor was his agent for custody merely; that it was overdue when it was transferred; and therefore that the transferee took it subject to all defects. It is at once apparent that the principle of notice, actual or constructive, will not aid this claimant."

[100] All the cases in Group B 1 of the Appendix; all but one in B 2; the case in B 3; the Illinois, Louisiana, New Hampshire, and Texas cases in B 5; the Georgia, Illinois, Maryland, first New Hampshire, New Jersey, New York, and Texas cases in B 6; and the case in B 7 —twenty-seven decisions in all. In the three Illinois cases which do not protect the purchaser, the paper was not indorsed by the owner; but he did indorse in the two Illinois cases in note 101 which do protect the purchaser.

[101] Y. M. C. A. *v.* Rockford, 179 Ill. 599, 604, 54 N. E. 297 (1899); Kempner *v.* Huddleston, 90 Texas, 182, 185, 37 S. W. 1066 (1896). Justice *v.* Stonecipher, 267 Ill. 448, 452, 108 N. E. 722 (1915). And see 2 L. R. A. N. S. 769–70, note. Compare Eversole *v.* Maull, 50 Md. 95 (1878) with McKim *v.* King, 58 Md. 502 (1882). See also the cases which estop the owner of a non-negotiable chose in action who transfers it by writing. 30 Harv. L. Rev. 104, note 17.

[102] Zeis *v.* Potter, 105 Fed. 671, 675 (C. C. A. 7th, 1901) Woods, J., *semble:* "The purchaser of overdue or non-negotiable paper, if required to inquire of the makers

subject to all equities of secondary parties and no others. Much can be said for its validity, and indeed its advocates might direct a powerful attack against the solution of the problem advocated by this article. If the purchaser after maturity is put on inquiry as to the equitable defenses of indorsers, they might argue that according to Chief Justice Shaw [103] he is then affected with notice of all the facts which he would have learned by such an inquiry. Any indorser who has an equitable defense has also in most instances an equity of ownership, and both rest on the same facts. For example, if he was induced to indorse by fraud, inquiry as to his equitable defense would disclose the circumstances of the fraud, and a purchaser knowing those facts would at once be aware of the claim for restitution of the instrument. He would have notice simultaneously of the equitable defense and the equitable claim, and if he purchased would take subject to both. Actual notice of one is necessarily actual notice of the other, and consequently it is objectionable to maintain that maturity gives constructive notice of the indorser's equitable defenses but not of his equitable right to the ownership of the instrument.

My reply would be, that maturity is only constructive notice, and constructive notice is not actual notice, indeed not notice at all, but simply a convenient fiction to express a rule of law that the person affected takes certain risks if he goes ahead with his purchase or other transaction. The extent of the risk depends on the nature of the transaction or the particular fact which gives him warning, "puts him on constructive notice." He is not held to know the facts of which he has notice. The owner of land takes the risk of a prior recorded mortgage, but he is not guilty of fraudulent mis-

whether they have any defense, may equally well be required to inquire into the rights of remote indorsers or others whose names appear on the paper. The payee and each successive indorsee, though he has parted with possession and title, may yet have an interest which, as against all but innocent purchasers for value and without notice, equity would protect; and, if convenience of inquiry is equivalent to notice of the rights of the maker, why not of any other, [when,] by reason of his name being on the paper, or by other means, the proposed purchaser is notified that he once had, and therefore may yet have, an interest? The maker often signs for accommodation, and the apparent indorser may be in fact the principal. The reasonable rule would seem to be that the purchaser of such paper should take subject to the equities of all who appear or are known to have had an interest in it."

[103] Baxter *v.* Little, 6 Met. (Mass.) 7, 11 (1843). "By this fact he is put upon inquiry, and therefore he shall be bound by all existing facts, of which inquiry and true information would apprise him."

representation if he says the land is unincumbered. In the same way, maturity does not actually inform the purchaser of defenses, but merely throws upon him the risk of them and of nothing else. If the purchaser is anxious to hold some wealthy indorser, he will be wise to go to him and make sure *he* has no defense. Then that contract will be safe, and the purchaser need not take the time to interview other parties. But if all equities of indorsers run, the omission to ask one insolvent indorser would be penalized by a loss of rights on all the contracts, should that indorser have been deprived of the paper by fraud. The prospective purchaser would have to ask all down the line to protect himself, and if he could not find one indorser, he would have good reason to worry for fear that this might be the very man who would eventually turn up and take the instrument away from him. On business principles, each promise should stand by itself, good or bad. The conditions of trade in the note market require speedy transactions and make a protracted series of inquiries impossible. Consequently the buyer should be obliged to see only the parties whom he particularly wants to hold. If he omits an indorser, he takes the risk that that man may have a defense, but rights on other contracts remain unaffected.

An extremely liberal view, suggested in a few cases,[104] is that dishonor simply concerns the maker or drawee. The purchaser after maturity is bound to ask the primary party the reason for non-payment, and if he does not ask, he is subject to whatever equities he would have learned about from the maker or drawee. The payee or other holder who loses the instrument or is deprived of it by some fraud must notify the primary party not to pay if he wishes to preserve his rights. The purchaser is taken to know all that the maker or drawee knows, and no more. The reason for non-payment may be an equitable defense of the maker's or it may be theft from the payee, who has stopped payment. This view, though ingenious, would be hard to apply. Questions

[104] See the authorities cited in note 57, *supra;* Proctor *v.* McCall, 2 Bailey (S. C.) 298, 302 (1831). Harper, J.: "It would seem much more reasonable, to require the payee or true owner to give notice of the loss to the party liable to pay."

Y. M. C. A. *v.* Rockford, 179 Ill. 599, 605, 54 N. E. 297 (1899), the passage quoted in note 107, *infra.*

In National Bank *v.* Texas, 20 Wall. 72, 77 (1873) it appears that the purchaser made inquiries of the maker.

about what the maker knew, whether the purchaser did inquire, and so on, would continually arise. Moreover, the equitable defenses of the indorser who did not notify the maker would be cut off after maturity. Incidentally, the fact that the maker or drawee knows of a theft from the payee does not necessarily justify his refusal to pay the instrument, for the payee's equity may conceivably be cut off. Whether it is cut off, is the very question now under discussion.

The latent equities view is sound in maintaining that the equities of outsiders ought not to be let in, but its supporters admittedly rest it on *Murray* v. *Lylburn*,[105] so that there is danger that courts which reject Kent's doctrine as to non-negotiable choses in action will treat this view in the same way. However, there is a clear distinction between mere choses in action and overdue paper, and if the judges can be made to perceive this, the unjust doctrine of *In re European Bank*[106] may be permanently repudiated in the United States. Furthermore, the latent equity argument is sometimes used by the cases to reënforce the estoppel argument, and secure protection for the purchaser even against the equitable claims of prior owners.[107]

3. It is arguable that the rights of the *bonâ fide* purchaser after maturity should depend on the time at which the defrauded owner parted with the instrument. If it was then overdue, the fraud could not have been a reason for non-payment, and the purchaser should be protected. Also the "authority" given before maturity may be considered to terminate at maturity, but if it does not commence till after the instrument is overdue, it is still in full effect at the time of the transfer to the *bonâ fide* purchaser.[103]

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[105] 2 Johns. Ch. 441 (1817).

[106] L. R. 5 Ch. App. 358 (1870).

[107] Y. M. C. A. *v.* Rockford, 179 Ill. 599, 605, 54 N. E. 297 (1899). Wilkin, J. (after speaking of the rule that the maker's equities are not cut off):: "To extend the same protection to whoever may have acquired some collateral interest in the paper, in the absence of actual notice of the same to a transferee, would be to charge him with knowledge of a fact not within his power of ascertainment and practically destroy the negotiability of overdue instruments. . . . Persons dealing in such securities can without difficulty inquire of the makers if any defenses exist against them, but more than that it is not practicable to do. Of course, it would not be possible to discover, even by the utmost diligence, all persons that might have equitable rights in the subject matter."

[108] Eversole *v.* Maull, 50 Md. 95, 98 (1878), counsel for the purchaser, *arguendo;*

On the other hand, it has been pointed out that if the wrongdoer took the instrument before maturity, it was still negotiable in the fullest sense, and consequently he got the usual title or power which enables him to confer a good title on his transferee. The cases which declare that the theft of an overdue instrument gives no title cannot apply to a theft before maturity.[109] The magic of negotiability is still operative. This argument applies still more forcibly if the transfer to the wrongdoer was voluntary.

Clearly a distinction which works both ways is not worth much, and it is not surprising that the courts have paid no attention to it[110] with the exception of one case in Maryland,[111] which refused to safeguard a transferor after maturity, and even in Maryland the distinction was overlooked by a later case which did allow him to recover.[112]

It should be observed, however, that an owner who indorses the instrument after maturity makes it payable on demand, giving it a second maturity so far as he is concerned, *i. e.*, a reasonable time after he transfers. A *bonâ fide* purchaser for value within that reasonable time is a holder in due course as regards that indorser and should consequently be free from all his equities.[113] To this extent the third view seems sound.

This discussion of the authorities leads to the conclusion that a combination of the first and second views is probable. The *bonâ fide* purchaser of overdue paper may hope for protection from the claims of former owners who voluntarily transferred the paper,[114] and from the equities of outsiders,[115] although the decisions are sharply divided on both points. Once this result is firmly estab-

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and Miller, J., adopted his argument, saying, page 105, "The endorsement was made and the note delivered to (the agent for collection) *after its maturity*, so that the trust reposed in him by (the owner) *originated* after the note had matured, and was *continuing* at the time (the agent) sold it to (the purchaser)." This distinction has not been adopted in any other case. See 2 L. R. A. N. S. 768–69, note.

[109] So argued by Francis R. Jones, 11 HARV. L. REV. 44.

[110] The groups of cases in the Appendix show that it makes no difference as to the position of the owner whether he parted with the paper before or after maturity.

[111] Eversole *v.* Maull, 50 Md. 95, 105 (1878).

[112] McKim *v.* King, 58 Md. 502 (1882), not citing Eversole *v.* Maull.

[113] See the discussion on page 1125 and note 61. If equitable defenses are cut off, it is clear that equities of ownership ought to be, but the point has never been raised in litigation.

[114] Appendix, Groups A 2 and A 3. *Contra*, Groups B 5, 6, 7.

[115] Appendix, Group A 4. *Contra*, Group B 8.

lished, it will be only a step to include theft and finding and cut off equities of ownership altogether.

In view of the great conflict of authorities, however, it would be desirable to adopt a definite rule by legislation through an amendment to the Negotiable Instruments Law. That Act apparently leaves our problem untouched. The last sentence of section 16,[116] goes a long way toward the legal title theory by making the want of delivery an equitable defense even if at the inception of the instrument, but its terms do not extend to a purchaser after maturity, one way or the other. Section 55 is more important:

"The title of a person who negotiates an instrument is defective within the meaning of this act when he obtained the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud."

By section 57 a holder in due course holds the instrument "free from any defect of title of prior parties." [117] This may imply that a purchaser after maturity, not being a holder in due course, is subject to such defects, but such an implication is not necessary. The law ought not to be crystallized by vague inferences, especially as the section which provides for persons who are not holders in due course subjects them only to "defenses" and does not touch claims to ownership.[118] More significant still, section 36 (2) of the Bills of Exchange Act, which codifies the English view,[119] is not copied by the

[116] "But where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed." See note 37, *supra*.

[117] "§ 57. "A holder in due course holds the instrument free from any defect of title of prior parties, and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon."

"Defect of title" may possibly mean only equitable defenses and not equitable claims, but this is unlikely, first, because it is used in conjunction with "defenses," so would naturally mean something different, and secondly, because of the broad meaning of the term in the Bills of Exchange Act. See CHALMERS (7 ed.), pp. 101, 129, who says it is equivalent to "equity attaching to the bill." Lindley, L. J., in Alcock *v.* Smith, L. R. [1892] 1 Ch. 238, 263, defines it as "subject to equities." Such a phrase in the English cases includes all kinds of equities. See note 68.

[118] § 58. "In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable." The overdue instrument is certainly not "non-negotiable" in the sense of non-transferable. The word need not mean more than that equitable defenses are no longer cut off.

[119] See page 1128, *supra*.

Negotiable Instruments Law. Therefore the Act does nothing to settle the common-law conflict. Several cases decided under its provisions protect the *bonâ fide* purchaser after maturity.[120]

Inasmuch as equities of ownership run to a varying extent after maturity, according to the cases, it is useful to consider how these equities may become the basis of relief. Suppose a payee is induced by fraud to indorse in blank, and the defrauder transfers the note when overdue to a purchaser. The payee may, if the equity is not cut off, bring trover or its modern equivalent against the purchaser for the value of the instrument, or a bill in equity for restitution of the instrument itself as a unique chattel.[121] He may notify the maker not to pay any one but himself, and threaten suit, causing the maker to interplead the payee and the purchaser. Can the maker set up the payee's equity against the purchaser without interpleading the payee? He is allowed to do so in many cases,[122] but this procedure seems wrong. An issue which is really between the purchaser and the payee ought not to be fought out in litigation to which the payee is not a party. The judgment will not be *res adjudicata* as to him, so that even if the purchaser wins from the maker he may have to face a suit by the payee for the proceeds of the note. The maker should be required to interplead the payee [123] or else obtain authority from the payee to defend

[120] Wolf *v.* American, 214 Fed. 761 (C. C. A. 7th, 1914), N. I. L. not cited; Justice *v.* Stonecipher, 267 Ill. 448, 108 N. E. 722 (1915), citing and discussing the N. I. L.; Priest *v.* Garnett, 191 S. W. 1048 (Mo. App. 1917), N. I. L. not cited. Even under the Bills of Exchange Act, estoppel is held. Young *v.* MacNider, 25 Can. S. C. 272 (1895).

[121] The legal remedy is inadequate if the purchaser is insolvent.

[122] Lee *v.* Zagury, 8 Taunt. 114 (1817); Ashurst *v.* Royal Bank of Australia, 27 L. T. 168 (1856); McCormick *v.*Williams, 54 Iowa, 50 (1880); Davis *v.* Bradley, 26 La. Ann. 555 (1874); Owen *v.* Evans, 134 N. Y. 514, 31 N. E. 999 (1892); Osborn *v.* McClelland, 43 Ohio St. 284, 1 N. E. 644 (1885).

[123] Warren *v.* Haight, 65 N. Y. 171 (1875). In an action upon an overdue note by an indorsee after maturity against the maker, the maker was not allowed to set up the defense that the note represented the proceeds of property stolen from Mrs. N., which had come into the payee's hands with notice of the theft and been lent to the maker without notice to him.

Lott, Ch. C.: "If Mrs. N. had an *equitable* right to the money, before its loan to the defendants, and to the note subsequent thereto, that would not have been a legal defense to them if the present action had been brought by (the payee). . . . Mrs. N. is not a party to this action, and her rights could not be litigated in it."

Dwight, C.: "The plaintiff was the holder of the legal title to the note. . . . We hold that under such circumstances a party like Mrs. N. having, as is assumed, equitable rights, cannot intervene by mere notice so as to prevent the holder from collecting

in his behalf, so that the payee is the real defendant and will be bound by the judgment.[124]

Questions in conflict of laws are likely to arise because of the wide variance of views about overdue paper in different countries and among the States of this country. It is significant that the English courts, which make no distinction between equitable defenses and equitable claims when the overdue paper is in England, see the matter in a new light as soon as the paper is carried abroad, and recognize the difference between liability and ownership.[125] The liability of a party to a negotiable instrument is determined by the law governing his contract, *i. e.*, the law of the place where he became bound. Consequently, that law must determine whether or not equitable defenses are cut off after maturity. No other law can impose consequences upon his act to which he has not consented.[126] On the other hand, his liability is not directly affected by questions of ownership, for it is indifferent to him whom he pays, so long as he pays the lawful owner. Consequently, the title to an overdue instrument is not determined by the law of the place where it was made, but by the same law which governs the title to any other chattel, ordinarily the place where the chattel is and the physical act of transfer

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the note, but can only assert her rights in the usual mode; that is, by becoming a party to an action in which the respective rights of the parties can be adjudicated."

Ludwig *v.* Dearborn, 8 Pa. Dist. R. 69 (1899). Beitler, J.: "The defendants cannot resist payment of the note because the indorser notified them that he has failed to get the stock for which he endorsed the note. The maker has nothing to do with that."

Jones *v.* Broadhurst, 9 C. B. Rep. 173 (1850); Young *v.* MacNider, 25 Can. S. C. 272, 281 (1895), *semble*. For the general principle that a maker cannot set up the indorser's equities, see Prouty *v.* Roberts, 6 Cush. (Mass.) 19 (1850); Carrier *v.* Sears, 4 All. (Mass.) 336 (1862); City Bank *v.* Perkins, 29 N. Y. 554 (1864); Brown *v.* Penfield, 36 N. Y. 473 (1867); Kenney *v.* Kruse, 28 Wis. 183, 188 (1871); *Contra*, Parsons *v.* Utica Cement, 80 Conn. 58, 66 Atl. 1024 (1907); 82 Conn. 333, 73 Atl. 785 (1909).

[124] This is analogous to the cases when a bailee is sued on his contract, and is allowed to set up the *jus tertii* only if expressly directed by the claimant to defend on his behalf. Biddle *v.* Bond, 6 B. & S. 225 (1865).

For negotiable instrument cases of the same sort see Adams *v.* Jones, 12 Ad. & E. 455 (1840); Merchants' *v.* Savings Inst., 33 N. J. L. 170 (1868); Talman *v.* Gibson, 1 Hall (N. Y.), 308 (1828); Fulton *v.* Phoenix, 1 Hall (N. Y.), 562 (1829). But see Warren *v.* Haight, 65 N. Y. 171 (1875), which thinks the third party must actually become a party to the litigation.

[125] Alcock *v.* Smith, L. R. [1892] 1 Ch. 238 (C. A.).

[126] *Cf.* Robertson *v.* Burdekin, 1 Ross, L. C. Comm. L. 812 (1843), in which a note payable to A and made in Scotland was held to be transferred by indorsement in England, although such a note was not transferable by English law.

takes place. In *Alcock* v. *Smith*[127] a cheque and an unaccepted bill of exchange, drawn and payable in England, were sold in Norway when overdue against the consent of the owner. Norwegian law, unlike English, cuts off all equities after maturity as well as before. The English Court of Appeals applied the Norwegian law and decided that the purchaser had an unassailable title.[128]

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[127] L. R. [1892] 1 Ch. 238 (C. A.).

[128] The obligor is indirectly affected by these questions of title. Suppose he pays the person who would be entitled by the law of England where he contracted, without notice that some one else is entitled as a *bonâ fide* purchaser by the law of the place of transfer. Apparently English law would protect the obligor, under § 72 (2) of the Bills of Exchange Act. See also Lebel *v.* Tucker, L. R. 3 Q. B. 77 (1867). But it is doubtful if the obligor could set up the payment as a discharge if he were sued at the place of transfer by the purchaser. He is not really discharged, but only protected by England as a matter of policy.

The reasoning in Alcock *v.* Smith strongly supports the contention of this article that a negotiable instrument resembles a chattel as respects equities of ownership. The case relies on Cammell *v.* Sewall, 3 H. & N. 617 (1858), 5 H. & N. 728 (1860), which involved chattels.

It seems clear that if the owner of an overdue instrument consents to its presence in a jurisdiction where a *bonâ fide* purchase cuts off equities of ownership, the law of that country governs and the purchaser will be protected everywhere. A more difficult question arises when the instrument is carried to such a jurisdiction without the owner's consent and sold. Two views are possible. (a) The policy in favor of the *bonâ fide* purchaser of such paper may be so strong that the owner's consent to its presence is as immaterial as his consent to the sale. He keeps such an instrument at his peril, and any jurisdiction which gets the paper into its clutches can create new rights therein and divest the old. (b) The new jurisdiction has only a physical power over the chattel but cannot affect the title of the owner who has not submitted such a title to its control. This second view finds support in Wylie *v.* Speyer, 62 How. Pr. 107 (1881). Coupons were stolen by bank-robbers in Northampton, Massachusetts, before maturity, and were purchased *bonâ fide* when overdue in Frankfort-on-the-Main. By the law of Frankfort, the purchaser got a good title. The New York court, however, applied the *lex fori* and held that the purchaser had no title. This is clearly wrong, and the decision can be justified only on the ground that Massachusetts law applied and prevented the thief from having power to pass title after maturity. But see Embiricos *v.* Anglo-Austrian Bank, L. R. [1905] 1 K. B. 677 (C. A.). A cheque payable in England was stolen in Roumania and transferred in Austria under a forged indorsement before maturity. The law of Austria was applied, and the *bonâ fide* purchaser protected. This is contrary to Wylie *v.* Speyer unless the law of Roumania, of which nothing was said, is like that of Austria. The second view can also be supported by certain cases involving chattels. For instance, in Edgerly *v.* Bush, 8 N. Y. 199 (1880), horses were removed from New York without the owner's consent and sold in Canada in market overt. It was held that the New York title was not divested. Lord Cockburn took a similar view in Cammell *v.* Sewall, 5 H. & N. 728, 735 (1860). But Wightman, J., and Crompton, J., in the same decision, pp. 735, 745, thought the owner's consent to presence immaterial. They said that if foreign goods were wrecked in England or brought there by a thief, the owner's title could be divested

This concludes our theoretical discussion. It will be seen that the various theories of negotiability which reach a substantially uniform result as to current paper exhibit marked divergences when applied to the abnormal facts of overdue paper. In particular, the attempt to base negotiability upon the will of the victimized owner solves nothing. If he authorizes transfer by the wrongdoer before maturity nothing in his mental attitude or overt acts limits that authority and excludes transfers after maturity. He consents to both — or to neither. And when we find jurisdictions like Illinois recognizing some transfers after maturity on the basis of the victim's so-called deliberate action, certainty has utterly vanished. The authority theory moulds the will of the owner to fit the actual rules of law as a perjured witness moulds his memory to fit the pleadings.

This "authority" theory shades imperceptibly [129] into the doctrine that the wrongdoer has a power given by law to create a good title in the *bonâ fide* purchaser before maturity, but not after maturity. Why does the law stop short at maturity? It is just as easy for it to bestow a big power as a little one. Clearly, the so-called power is only an anthropomorphic method of explaining the result that the *bonâ fide* purchaser before maturity *is* protected. The greater the protection, the greater the power. To explain the protection by the power is hauling one's self up by one's boot-straps. In short, the starting-point in the discussion should not be the wrongdoer but the purchaser. Once the law determines that he is entitled to protection on completing his acquisition of a particular kind of property, the intervention of a wrongful act in his chain of title becomes immaterial.

The legal title theory measures that protection by the terms of the instrument, which make him the owner of a direct promise. The surprising fact is not that some equities should be cut off

in market overt. In view of these conflicting opinions, the question raised by Wylie *v.* Speyer merits more consideration than can be given at this time.

[129] How imperceptibly, is shown by a typical opinion on overdue paper, Foley *v.* Smith, 6 Wall. (U. S.) 492, 494 (1867), per Miller, J. (The italics are mine.) "If (the owner) *trusted* the (wrongdoer) with her note, it was for a *purpose* which was ended when the note was protested. By indorsing the note she did *trust* the bank with full power to dispose of it before due, *although that was not intended*, and she *trusted* the bank for the return of the money to her if the money had been paid. *This trust the law implied*. But her *trust* ceased, except as to the mere possession of the note as a bailment, after the note was protested."

after maturity but that any equities should be let in, to affect *his* promise by transactions between other persons wholly unknown to him. Lord Kenyon's reluctance in *Brown* v. *Davies*[130] seems natural enough, especially as the rule of that case is unknown to a large portion of Europe,[131] where a *bonâ fide* purchaser after maturity is protected just as completely as our holder in due course.

The rule that lets in equitable defenses on overdue paper is logical but by no means inevitable. The rule that lets in equitable claims to ownership is neither inevitable nor logical nor just. The legal title theory not only conforms to the terms of the instrument, but gives the *bonâ fide* purchaser the protection to which business policy entitles him. In other words, it reaches the same result as the power theory if that theory be soundly applied, *i. e.*, if

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[130] See note 51, *supra*.

[131] *Overdue Paper in the Civil Law.*

The Scotch law paid no attention to maturity with respect to equities until the statute of 1856 compressed it into the English pattern. See note 68, *supra*. Bell, Principles of the Laws of Scotland, 6th ed., 1872, § 332.

In France, the Code and subsequent statutes seem to cut off equities of ownership for all practical purposes upon instruments indorsed in blank or payable to bearer. The victim of loss or theft can recover (*revendiquer*) his instrument, but must reimburse the *bonâ fide* purchaser for the price paid. The victim can protect himself by advertising the loss or theft in the *Bulletin du Syndicat*, and purchasers after the advertisement are held to have notice. THALLER, TRAITÉ DE DROIT COMMERCIAL (5 ed.), 1916, §§ 900 *ff.*, 1481. Equities of ownership on an order instrument would apparently be cut off in the same way. The authorities differ as to equitable defenses after maturity. LYON-CAEN ET RENAULT, TRAITÉ DE DROIT COMMERCIAL (4 ed.), 1907, IV, § 135, say they are cut off, and cite cases to that effect from the Court of Cassation. They argue forcibly that maturity does not cause the essential elements of a bill of exchange to disappear. ADOLPHE PICHON, DE L'INOPPOSABILITÉ DES EXCEPTIONS AU PORTEUR D'UN TITRE À ORDRE (1904), 231, takes a position even stronger, that freedom from defenses is necessary to promote circulation before maturity. Thaller, *op. cit.*, § 1475, thinks that equitable defenses ought not to be cut off, but admits that the course of decisions is against him. Story states the French law as like the English (PROMISSORY NOTES, § 179) on the authority of Pardessus, COURS DE DROIT COMMERCIAL, I, § 352, who, however, makes the same admission as Thaller.

In Germany (BILLS OF EXCHANGE ACT, Art. 16) and Switzerland (CODE DES OBLIGATIONS, Art. 734) a special distinction is made. If no protest has been made, both equitable defenses and equities of ownership are cut off, but if protest has been made the indorsee gets only the rights of his indorser. THE COMMERCIAL LAWS OF THE WORLD, Vol. XXV, 426, London. See LYON-CAEN ET RENAULT, *op. cit.*, § 135 bis; THALLER, *op. cit.*, § 1475, note 3. Wylie *v.* Speyer, 62 How. Pr. (N. Y.) 107 (1881).

In Norway and Sweden, an overdue bill is treated exactly like a current bill with respect to equities. Alcock *v.* Smith, [1892] 1 Ch. 238, 253 (C. A.).

For the law of other countries, see LYON-CAEN ET RENAULT, *loc. cit.*; PICHON, *op. cit.*, 238, note.

the power be coextensive with the protection due the *bonâ fide* purchaser after maturity.

IV. Practical Considerations

Theory and practice are improperly opposed. If a proposition is bad in practice, then its theory is wrong. A sound theory must work well, in law as elsewhere. Let us test the solution of the overdue paper problem, which we have laboriously framed out of legal theories, by the needs of the business world. Will it promote commerce if it is definitely understood that an honest purchaser of overdue paper can keep and collect it, regardless of the wrongs inflicted on former owners by the man from whom he buys? It is rare indeed that honest man and rogue face one another in court. In this instance, as so often in the law, we have to decide between two innocent persons who have both suffered through the acts of a scoundrel who vanishes with his ill-gotten gains. Does the law care more about the owner of property which is taken away from him, or about the honest man who buys it from the wrongdoer? Clearly there is no universal rule. If the property is a watch, the law protects the owner; if it is a five dollar bill, the acquirer. On which side of the line does overdue paper fall?

Why is the five-dollar bill treated differently from the watch?

"In the conflict of interests between owners and acquirers of certain special classes of property the free circulation of which is of particular business utility, the social importance of encouraging transactions, of 'preventing property from stagnating' has resulted in legal protection of the interests of the *bonâ fide* purchaser even at the expense of the property rights of the previous owner. These special classes of property tend to become more numerous as a nation becomes more industrial and commercial in its economy, but they are as yet exceptional." [132]

When a man acquires property of one of these classes, and does everything necessary to complete the transaction, gets possession, obtains any writing that has to be done by his transferor, and then pays over the price, he can rest easy.

Current negotiable paper of course forms one of these exceptional classes, and overdue paper should also be included. It is intended to circulate after it becomes due,[133] should it for any

[132] The Enforcement of Decrees in Equity, C. A. Huston, 130.

[133] Parker *v.* Stallings, Phil. L. (N. C.) 590, 593 (1868).

reason remain unpaid. There is nothing inherently iniquitous about its existence after maturity, or it would not be protected by the commercial law of the Continent.[134] It is frequently overdue from insolvency or temporary financial embarrassment of the parties. Shall it then be *caput lupinum*, an outlaw, to be knocked on the head? The conditions of the money-market do not favor prolonged inquiry. It must pass free from the claims of former owners, or it is very likely not to pass at all.

This is a consideration which should never be forgotten, that every defect of title to which an honest buyer is exposed by law is a serious injury to honest prospective sellers. For every purchaser who buys and loses, another may be scared off for fear of the hidden danger, unless the seller's credit is good or conditions are such that the lawfulness of possession can be easily investigated. Such investigation of overdue paper is very difficult, and unsuited to the conditions under which most negotiable instruments are bought and sold. The buyer will not be reassured by the statement that he is safe if an honest person owned the instrument before its maturity,[135] for how can he be sure of that fact? Consequently, if the buyer takes overdue paper at his own risk, he will often not take it at all. Not only wrongdoers but innocent investors will suffer accordingly. The moment their negotiable paper becomes overdue, it will tend to remain on their hands and become a drug on the market.

Whatever depreciates overdue paper depreciates current paper. It is less valuable before maturity if subject to the ever-present danger that it may become overdue for financial reasons and then be hard to sell. The easier it is to sell through its whole life, the more attractive an investment it becomes. Any one who is offered negotiable paper before maturity will buy it more readily if he is sure of getting money on it at maturity either by payment or by selling it. As a French writer observes,[136] "It is an economic error to separate circulation before maturity from circulation after maturity. If we look at things as a whole and preserve their true re-

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[134] See note 131.

[135] Negotiable Instruments Law, § 58 (last sentence); Chalmers *v.* Lanion, 1 Camp. 383 (1808).

[136] A. Pichon, De l'Inopposabilité des Exceptions au Porteur d'un Titre à Ordre, p. 336. Paris, 1904.

lations, the rapidity of circulation before maturity depends in part upon the rapidity of circulation after maturity."

The rule advocated by this article will encourage negotiable paper, and such encouragement is especially needed at the present time. First, the tremendous destruction of capital for military purposes is liable to cause eventual financial stringency and inability to meet many obligations at maturity. No sensible person supposes that he buys a coupon bond at his peril because one or two coupons are overdue. This delay in payment does not necessarily indicate any theft or fraud, but suggests "only causes of a temporary nature." [137] Default of the principal will frequently occur during the next few years for the same reason. Such default makes it impossible for the investor to turn his securities into cash by obtaining payment. It should not also increase the difficulty of doing so by sale. The price will be low enough anyway after dishonor. It ought not to be forced down further by a sudden shift of the risk to the buyers and a consequent loss of market.

Secondly, negotiable paper and incidentally overdue paper ought to be encouraged for public as well as private reasons. It forms the basis of currency issues under the Federal Reserve Act, and should therefore be made as fluid a security as possible whether mature or not. Furthermore, the War, besides increasing the difficulty of meeting obligations, has vastly multiplied the bonds of all nations and has placed them in the hands of a new class of investors who should be given every confidence in these securities. A possible postponement of the payment of principal should not have any serious effect which can be avoided. Overdue coupons are a more immediate problem. Ignorant bondholders will often hold coupons past maturity through forgetfulness. They ought nevertheless to be easily convertible into money, which means that they should be free from hidden defects of title.

Consequently the courts — or better still, the legislatures,[138]

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[137] Cromwell *v.* Sac, 96 U. S. 51, 58 (1877).

[138] This result might be secured by an addition to section 57 of the Negotiable Instruments Law, somewhat in the following form: "A holder who has taken the instrument in compliance with the first, third, and fourth conditions of section fifty-two holds the instrument free from any defect of title of prior parties, but not free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties who have no defenses of their own."

should adopt a definite rule, that the honest buyer of overdue paper can hold it against all the world, and enforce it against all parties who have no defenses of their own.

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APPENDIX: CASES ON CLAIMS TO THE OWNERSHIP OF OVERDUE PAPER

A. *Boná Fide* Purchaser Protected

A 1. *Cases which Protect the Boná Fide Purchaser of Overdue Paper from a Wrongdoer (W) who Obtained Possession Without the Consent of the Owner (O)*

National Bank *v.* Texas, 20 Wall. (U. S.) 72 (1873), — bearer bonds belonging to the state of Texas which the illegal secession government of the state was alleged to have transferred to raise money for use in the Civil War. The majority of the court held that it was not proved that the bonds in suit were among those transferred for this unlawful purpose. Swayne, J., concurring held that the transferee of an overdue instrument is subject only to equities of the obligor, citing Murray *v.* Lylburn.

Sanderson *v.* Crane, 2 Green (14 N. J. L.), 506, 509 (1834), *semble.*

A 2. *Cases which Protect the Boná Fide Purchaser of Overdue Paper from a Wrongdoer (W) to whom the Paper was Voluntarily Transferred by its Owner (O) before Maturity*

Y. M. C. A. *v.* Rockford, 179 Ill. 599, 54 N. E. 297 (1899), — order notes indorsed in blank by O; W, pledgee;

Justice *v.* Stonecipher, 267 Ill. 448, 108 N. E. 122 (1915, under N. I. L.), order notes indorsed in blank by O; W, custodian for collection of interest;

Moore *v.* Moore, 112 Ind. 149, 13 N. E. 673 (1887), — order note indorsed by fraud of W without consideration;

Kiefer *v.* Klinsick, 144 Ind. 46, 58, 42 N. E. 447 (1895) *semble* — explaining Moore *v.* Moore;

Etheridge *v.* Gallagher, 55 Miss. 458 (1877), — order note indorsed in blank by O, consideration failed;

Priest *v.* Garnett, 191 S. W. 1048 (Mo. App. 1917), — order note indorsed in blank by O; W, with power to pledge, sold.

A 3. *Cases which Protect the Boná Fide Purchaser of Overdue Paper which the Owner (O) Voluntarily Transferred after Maturity*

Young *v.* MacNider, 25 Can. S. C. 272 (1895), — W, administrator and agent of estate allowed by legatees to retain overdue bonds, pledged them;

Wolf *v.* American, 214 Fed. 761 (C. C. A. 7th, 1914), — overdue certificate of deposit specially indorsed by O to W, a pledgee, with power to repledge for limited amount; W repledged for more;

Connell *v.* Bliss, 52 Maine, 476 (1864), — order note indorsed in blank by O; W, attorney for purposes of suit;

Eversole *v.* Maull, 50 Md. 95 (1878), — W, agent for collection;

Gardner *v.* Beacon, 190 Mass. 27, 76 N. E. 455 (1906), — order notes indorsed by O; W, fraudulent;

Church *v.* Clapp, 47 Mich. 257 (1881), — W, mere bailee;

Cochran *v.* Stewart, 21 Minn. 435 (1875); 57 Minn. 499, 59 N. W. 543 (1894), — order notes indorsed in blank by O; W, fraudulent and consideration failed;

Lee *v.* Turner, 89 Mo. 489, 14 S. W. 505 (1886), — order note indorsed; W, agent for collection;

Neuhoff *v.* O'Reilly, 93 Mo. 164, 6 S. W. 78 (1887), — order note indorsed by O in blank without delivery and by W, her administrator, who sold without inventorying it;

Parker *v.* Stallings, Phil. L. (N. C.) 590 (1868), — order note indorsed in blank; W, agent for collection;

Hill *v.* Shields, 81 N. C. 250 (1879), — order note indorsed in blank; W agreed O should not be liable (parol evidence rule as second ground);

Bradford *v.* Williams, 91 N. C. 7 (1884), — order note indorsed in blank; W, agent for collection;

Kempner *v.* Huddleston, 90 Texas, 182, 37 S. W. 1066 (1896), — order note specially indorsed to W for safe keeping.

A 4. *Cases which Protect the Bonâ Fide Purchaser from the Claims of Persons who have Never had Legal Title to the Instrument*

Mohr *v.* Byrne, 135 Cal. 87; 67 Pac. 11 (1901), — order note indorsed by W, the payee, not subject to alleged fractional interest of outsider (probably overruling Chase *v.* Whitmore, 68 Cal. 545, in which *cestui's* equity was held to run; that case also rests on another ground, that the provision for attorney's fees rendered the note nonnegotiable);

Crosby *v.* Tanner, 40 Iowa, 136 (1874), — order note indorsed, not subject to agreement by payee with outsider to cancel note and mortgage securing it so as to make outsider's second mortgage a first lien;

Blake *v.* Koons, 71 Iowa, 356, 32 N. W. 379 (1887), — order note indorsed, not subject to equities of maker's creditors who assert the mortgage secured thereby is in fraud of creditors;

Hibernian *v.* Everman, 52 Miss. 500 (1876), *semble*, — order notes properly indorsed, not affected with partnership rights of partner of payee's son, even if notes were overdue;

Sanderson *v.* Crane, 2 Green (14 N. J. L.), 506 (1834), — order note indorsed by payee who had passed through insolvency but had concealed this note from his assignee not affected with equities;

See also Osgood *v.* Bank, 30 Conn. 27 (1861).

B. *Bonâ Fide* Purchaser Not Protected

B 1. *Cases which do not Protect the Bonâ Fide Purchaser of Overdue Paper from a Wrongdoer (W) who Stole the Paper before Maturity*

Texas *v.* White, 7 Wall. (U. S.) 700 (1868), — "O or bearer" bonds belonging to the state of Texas were sold after secession to raise money for use in war. The title of the state was not divested and it can recover the bonds from a *bonâ fide* purchaser for value. Swayne, Grier, and Miller dissent;

Texas *v.* Hardenberg, 10 Wall. (U. S.) 68 (1869), — same bonds, but the purchase was not in good faith;

Huntington *v.* Texas, 16 Wall. (U. S.) 402 (1872), *semble*, — same bonds;
Vermilye *v.* Adams Express, 21 Wall. (U. S.) 138 (1874), — United States treasury notes payable to bearer, actual notice seems to be held though there was no bad faith, but negligence at most;
Von Hoffman *v.* United States, 18 Ct. Cl. 386 (1883), — bearer bonds; reversed by Morgan *v.* United States, 113 U. S. 476 (1885), solely on ground that the bonds were not overdue;
Gilbrough *v.* Norfolk, 1 Hughes C. C. 410 (1877), — bearer bonds;
Hinckley *v.* National Bank, 131 Mass. 147 (1881), — bearer coupons, *sed quaere* as to voluntary transfer obtained by fraud;
Northampton *v.* Kidder, 106 N. Y. 221, 12 N. E. 577 (1887), — bearer bonds;
Wylie *v.* Speyer, 62 How. Pr. (N. Y.) 107 (1881), — bearer coupons.

B 2. *Cases which do not Protect the Bonâ Fide Purchaser for Value of Overdue Paper from a Wrongdoer (W) who Stole the Paper after Maturity*

Down *v.* Halling, 4 B. & C. 330 (1825), — check; theft or finding have the same effect;
Greenwell *v.* Haydon, 78 Ky. 332 (1880), — order bond, but indorsed in blank by payee and not by O, a later holder;
Davis *v.* Bradley, 26 La. Ann. 555 (1874), — order bill of exchange, indorsed in blank by the payee and not by O, a later holder;
McCorkle *v.* Miller, 64 Mo. App. 153 (1895), *semble*, — order note, indorsed in blank by the payee and not by O, a later holder;
Arents *v.* Commonwealth, 18 Grat. (Va.) 750 (1868), — bearer coupons.

B 3. *Cases which do not Protect the Bonâ Fide Purchaser for Value of Paper which was Lost before Maturity*

Vairin *v.* Hobson, 8 La. 50 (1835), — bearer check, purchase with notice a second ground for decision.

B 4. *Cases which Protect the Bonâ Fide Purchaser of Overdue Paper Voluntarily Transferred but have Dicta Distinguishing Theft, Finding, etc.*

Y. M. C. A. *v.* Rockford, 179 Ill. 599, 604, 54 N. E. 297 (1899), fraud included;
Justice *v.* Stonecipher, 267 Ill. 448, 108 N. E. 722 (1915);
Gardner *v.* Beacon, 190 Mass. 27, 76 N. E. 455 (1906);
Etheridge *v.* Gallagher, 55 Miss. 458, 469 (1877), fraud included.

B 5. *Cases which do not Protect the Bonâ Fide Purchaser of Overdue Paper from a Wrongdoer (W) to whom the Owner (O) Voluntarily Transferred the Paper before Maturity*

Goggerly *v.* Cuthbert, 2 B. & P. N. R. 170 (1806), *semble*, — order bill indorsed by the payee, O, transferred to W for discount who absconded;
Foley *v.* Smith, 6 Wall. (U. S.) 492 (1867), — order note, indorsed in blank by O and O's agent for collection, sold by O's subagent;
Hide *v.* Alexander, 184 Ill. 416 (1900), — order note, but indorsed in blank by party prior to O; W, agent for renewal;
Merchants *v.* Welter, 205 Ill. 647, 56 N. E. 809 (1903), — order note indorsed in blank by maker; W, agent for renewal;
Bird *v.* Cockrem, 28 La. Ann. 70 (1876), — order notes, indorsed in blank prior to acquisition by O; W, a mere custodian;

Ford *v.* Phillips, 83 Mo. 523 (1884), — order note indorsed; W, agent for collection;
Quimby *v.* Stoddard, 67 N. H. 283, 35 Atl. 1106 (1892), — "O or bearer" notes; W, custodian for safe keeping;
Osborn *v.* McClelland, 43 Ohio St. 284, 1 N. E. 644 (1885), McIlvaine, C. J., dissenting, — order note, indorsed in blank by O and delivered to W, a firm for temporary use in raising money, sale by member of firm after its dissolution and long after expiration of O's authority; court expressly repudiates any estoppel under the circumstances;
Walker *v.* Wilson, 79 Texas, 185, 14 S. W. 798, 15 S. W. 402 (1890), — bearer note, used contrary to agreement.

B 6. *Cases which do not Protect the Bonâ Fide Purchaser when the Owner (O) Voluntarily Transferred after Maturity*

Lee *v.* Zagury, 8 Taunt. 114 (1817), — order bill indorsed by payee probably in blank and also by O, who took it up after maturity, canceled his indorsement, and sent it for collection to W, who sold it;
In re Sime, 3 Sawy. (U. S.) 305 (Cal. D. C. 1875), *semble*, — order certificates of deposit indorsed by O, sale by W, in breach of agreement;
Clark *v.* Sigourney, 17 Conn. 511 (1846), — order note indorsed in blank by payee who died before delivery, sale by executrix without further indorsement (a very questionable decision, two judges dissenting);
Thomas *v.* Kinsey, 8 Ga. 521 (1850), — "O or bearer note;" W, agent for collection;
Towner *v.* McClelland, 110 Ill. 542 (1884), — order note, indorsed in blank by party prior to O; W, agent for collection (case also rests on point that an assignee of a mortgage who seeks foreclosure is subject to the defense of payment to a prior assignee);
McCormick *v.* Williams, 54 Iowa, 50 (1880), — W, agent for collection;
Wood *v.* McKean, 64 Iowa, 16 (1884), — order note indorsed in blank by O, who pledged to W and left it in W's hands after paying W;
Henderson *v.* Case, 31 La. Ann. 215 (1879), — order bill indorsed in blank; W, agent for collection;
McKim *v.* King, 58 Md. 502 (1882), — bearer coupons; W, depository for refunding;
Emerson *v.* Crocker, 5 N. H. 159 (1830), — order notes indorsed in blank by party prior to O; W, agent for collection;
Farnham *v.* Fox, 62 N. H. 673 (1883), — probably order note; W, authorized to pledge for a certain amount and pledged for more;
Midland *v.* Hitchcock, 37 N. J. Eq. 349 (1883), — bearer bonds; W, bailee for reorganization (judges differ on reasons);
Farrington *v.* Park Bank, 39 Barb. (N. Y.) 645 (1863), — notes transferable by delivery; W, agent to deposit for collection who misappropriated;
Weathered *v.* Smith, 9 Texas, 622 (1853), — "O or bearer" note; W, agent for collection.

B 7. *Cases which do not Protect the Bonâ Fide Purchaser when the Owner (O) Transferred the Paper Voluntarily but it is Uncertain whether the Transfer was before or after Maturity*

Stern Brothers *v.* Germania Bank, 34 La. Ann. 1119 (1882), — bearer coupons; W, agent for collection.

B 8. *Cases which do not Protect the Boná Fide Purchaser of Overdue Paper from the Claims of Persons who Never had Legal Title to the Instrument*

Ashurst *v.* Royal Bank of Australia, 27 L. T. 168 (1856), — bearer note transferred to a *boná fide* purchaser for value by a bankrupt when overdue is subject to claim of his assignee, (but the same result would follow if it were not overdue because bankruptcy is constructive notice);

In re European Bank, L. R. 5 Ch. App. 358 (1870), — W bought overdue bills with money of O's he had to invest;

West *v.* MacInnes, 23 U. C. Q. B. 357 (1864), — W bought note with money of O's he had to invest;

Young *v.* MacNider, 25 Can. S. C. 272, 277 (1895), *semble,* — estoppel held;

Turner *v.* Hoyle, 95 Mo. 337, 8 S. W. 157 (1888), — order note, indorsed in blank, bought from a trustee when overdue, affected with *cestui's* rights (also there was notice of the trust from the papers);

Mayer *v.* Columbia, 86 Mo. App. 108 (1900), — same result (with no notice from papers);

Owen *v.* Evans, 134 N. Y. 514, 31 N. E. 999 (1892), *semble,* — indorsee after agreeing to sell an overdue note and mortgage to the plaintiff, who paid value, transferred them many years later to the defendant who was not a *boná fide* purchaser for value, and was not protected;

Kernohan *v.* Durham, 48 Ohio St. 1, 26 N. E. 982 (1891), — the payee of a note secured by mortgage transferred the mortgage and a forged copy of the note for value to the plaintiff, and afterwards indorsed the true note, now overdue, to the defendant and agreed to assign to him the mortgage; the defendant though a *boná fide* purchaser for value of the note is subject to the plaintiff's equity. (The defendant would have priority if he had bought before maturity). Kernohan *v.* Manss, 53 Ohio St. 118, 41 N. E. 258 (1895).